Financial Statements Analysis and Reporting

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Lecture – 54
Preparation of Cash Flow statement-Basic cash Flow statement

Welcome students. So, we are in the process of preparing the cash flow statement and after my say same building up of the theoretical foundation about the cash flow statement and its importance of the means discussing with you the importance of the cash flow statement. Now we will learn that how to prepare the cash flow statement actually. And, for preparing the cash flow statement we have to pass through the 3 steps.

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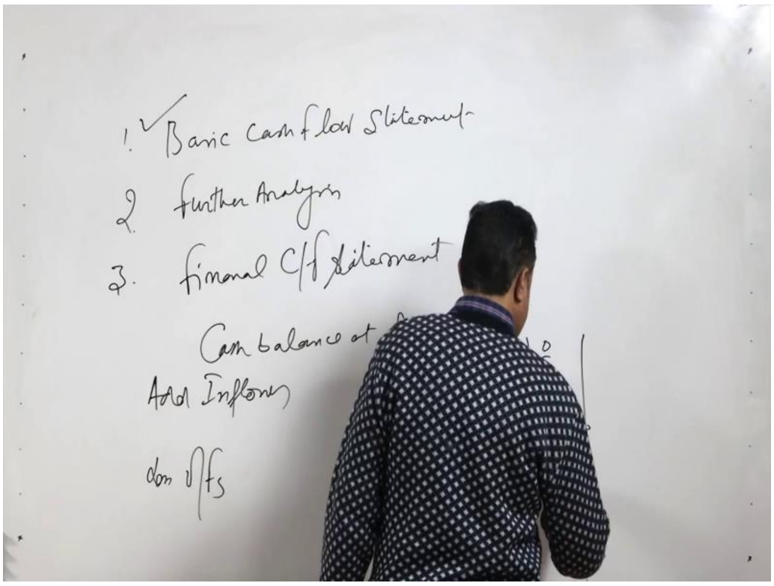

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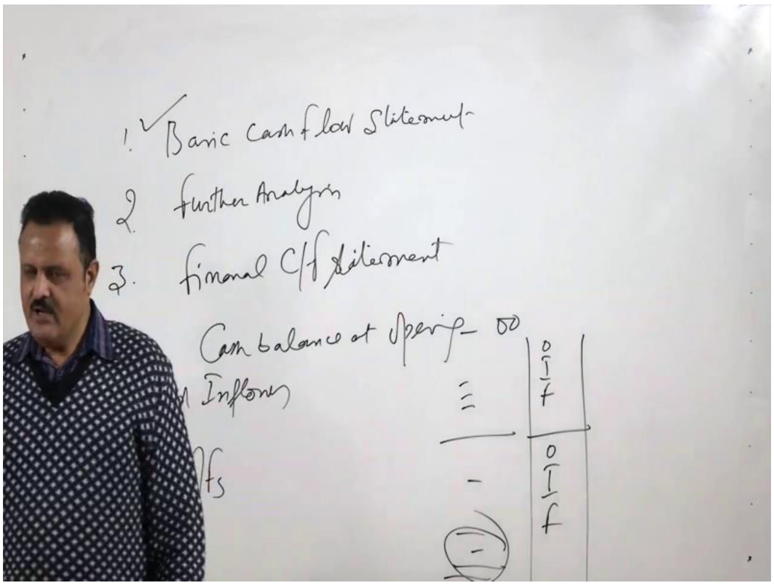

First step is will have to learn to prepare the basic cash flow statement; basic cash flow statement, this is called as the basic cash flow statement and this is one first step. Second is that will have to make the further analysis of the items relating to inflow and outflow of the cash and then finally, end up with the preparing the final cash flow statement. I have to end up preparing the final cash flow statement.

These are the 3 steps. So when this AS 3 was not there or the final cash flow statement under these 3 activities operating investing and financing was not required to be prepared then even the basic cash flow statement was sufficient. Basic cash flow statement is a summed up process and there we only get to know or verify or able to verify that the cash balance shown in the balance sheet is correct or not.

And what are the sources of that cash? How much cash is actually flow flown in the firm and how much cash as flow out of the firm and the balance been shown that is a opening balance and the closing balance of the cash been shown in the balance sheet, means the auditor was verifying in a way that whether that is say existing in the bank account also. So, auditor will have to check the bank account so that that much of the cash is available in the bank; cash in hand plus cash in bank. And second thing was that that cash balance is confirmed that yes it has been received by the business during this year. So, total cash flow flown into the business is this much, flown out of the business is this much and net balance available is this much. So, this much the only job to be done by preparing the basic cash flow statement.

But now that is not going to serve the purpose. So, we will have to prepare it under the different activities. So, basic cash flow statement does not help us to prepare the cash flow statement that way where we can categorize that how much cash is flowing in from the operations from the investing and from the financing activities. But first we will prepare the basic cash flow statement and will begin from there. And in the basic cash flow statement one amendment has been made that when you we are preparing the basic cash flow statement. In the last column we will have to show because we are taking only 3 things into account.

In the basic cash flow statement what we are taking we are taking that is a cash balance at opening. So, what is the opening balance of cash we start with this. When we started this year one particular year for example, this year is 2016. So, if any company starts their operating period is from January to December. So, when the business was started a business started its transaction on the 1st January 2016, how much cash was there in the company’s account. So, we will start with this cash opening balance of the cash. And then during the year how many transactions were done what different kind of transactions were done certainly the cash must have flown in and flown out and so we will take this in opening balance of the cash we will add inflows; we will be adding inflows so all the inflows will be here and then we will be doing less outflows, so outflows will be subtracted, and finally the closing cash balance will be calculated here.

And this closing cash balance should be as same as there been shown in the balance sheet of the current year.

So, now earlier this was serving the purpose, but now you have to make one extra column here in the basic cash flow statement also. And when they are showing the sources of inflow you have to categorize whether it is operating activities or source of the inflow is operating or investing or financing you have to put that here. But together may be not say first operations and then investing and then financing no you have to take all the sources of inflow, but you have to categorize whether it is operating inflow, investing inflow, or the financing inflow.

Similarly, you have to put here also in case of the outflows also whether it is in operating outflow, investing outflow, or the financing outflow. So, you have to be careful and we have to say categorize these sources of inflow and outflow avenues of outflow under these 3 or different kind of a activities. But it is not a final cash flow statement. And then we will have to move to the next step that to adjusting all the information; say we have to take into consideration the information given in the balance sheet and then profit and loss account balance sheet and some additional information we have to adjust make a proper analysis. Find out the balance with the help of further analysis which will those balance is the final cash flow statement and we will have to prepare that activity wise.

So, we will learn now practically, how to prepare the cash flow statement and how to analyze the prepared cash flow statement. So, if you look at the monitor there we have the case of Skyline Industries Limited. And we will be preparing the cash flow statement for the Skyline Industries.

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SKYLINE INDIA LIMITED
Balance Sheet
AS AT 31st March, 2007

	2007 (Rs. in lacs)	2006 (Rs. in lacs)
SOURCES OF FUNDS		
Shareholders' Funds		
Share Capital	100.00	62.50
Reserve and Surplus	163.70	69.00
	263.70	131.50
Loan Funds		
Secured (Long term) :		
• 12% debentures	15.00	.....
• Others	49.50	44.00
Unsecured (Short term)	6.00	8.00
	70.50	52.00
Deferred Tax Liabilities	32.00	45.00
TOTAL	366.20	228.50
APPLICATION OF FUNDS		
Fixed Assets		
Gross Block	174.00	95.50
Less: Accumulated depreciation	72.50	53.00
Net Block	101.50	42.50
Capital Work-in-Progress	5.00	2.50
	106.50	45.00

This is the balance sheet of the Skyline Industries which is showing the sources of funds first this is the share capital then reserves and surplus, loans secured and unsecured loans, deferred tax liability, these are the sources of funds. The total is 366.20 lakhs and means 3, 66,00,000 it means 3.66 [FL] and earlier it was 2.28 [FL]. And then it is a application of the funds that where the funds are going, how the funds are invested in the firm. So, if you look at this we have the fixed assets here which is the gross block then depreciation the net block and capital work in progress.

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Investments		
Long term	99.00	105.00
Short term	43.50	21.75
	142.50	126.75
Current Assets, Loans and Advances		
Inventories	28.00	78.00
Sundry Debtors	85.00	72.50
Cash and Bank Balances	10.00	2.75
Interest receivables	5.00	2.00
Loans and advances	12.00	15.00
	140.00	170.25
Less: Current Liabilities and Provisions		
Current liabilities:		
• Sundry creditors	16.50	94.50
• Interest payable	2.50	5.00
Provisions:		
• Current income tax (Net of advance tax paid	3.00	5.00
• Proposed dividend	15.00	12.50
• Corporate dividend tax	1.80	1.50
	38.80	118.50
Net Current Assets	101.20	51.75
Miscellaneous Expenditure (To the extent not w/o)	16.00	5.00
TOTAL	366.20	228.50

And then the other items are here, that is a investment, long term investment, short term investments than the current assets and current liabilities, and finally the balance sheet is balanced. Here we have the total of liabilities 366.20, earlier it was 228.50 lakhs.

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SKYLINE INDIA LIMITED

Profit and Loss Account for the year ended 31st March, 2007

Particulars	(Rs.) in lacs
Sales	1532.50
Interest	15.00
Dividend	10.00
Total Income	**1557.50**
Materials cost	1121.00
Manufacturing expenses	174.75
Administrative and selling expenses	60.25
Depreciation	22.50
Interest	7.25
Deficit on fixed assets sold	0.25
Miscellaneous expenditure w/o	4.00
Profit Before Taxation and Extraordinary Item	**167.50**
Expenditure income – Compensation for copyright infringement	9.00
Profit Before Taxation	**176.50**
Provision for Income Tax:	
• Current income tax	25.00
• Deferred income tax	15.00
Total	40.00
Profit After Tax	**136.50**
Balance brought forward from last year	14.50
Balance Available for Appropriations	**151.00**
Appropriations:	
• Proposed dividend	15.00
• Current dividend tax	1.80
• General reserve	120.00
Surplus Carried to Balance Sheet	**14.20**

Now, we have the profit and loss account also for the Skyline India limited and you start with the sales which is again in lakhs given to us and that is 1,532 lakhs of the sales. Then we have the different say other incomes like interest income, dividend income, total income are these then these are the cost part then we have calculated the income before, tax and extraordinary items, then we have taken made the provision for tax, then we had say the total say dividend and another kind of provisions, and finally we have the say the balance surplus which is carried to the balance sheet invested or added back in the capital of the company of share capital of the company.

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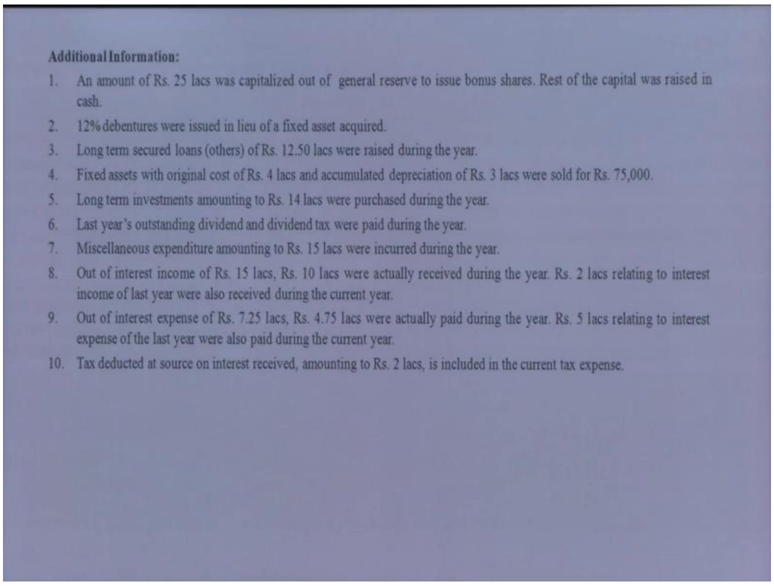

And here we have some additional information which we have to take into account while calculating the final cash flows under operating investing and financing activities. This additional information has to be used so that we will have to check it properly that how much cash inflow and outflow is being shown in the basic cash flow statement and how much it is finally moving to the final cash flow statement, because in the basic cash flow statement there must be some changes, because format is different the structure is different and sources are sources are same, but style is different structure, format is different which is totally different in the final cash flow statement.

So, it means we will have to use this balance sheet information, profit and loss information and the additional information, and then by say using these 3 sets of information we will have to prepare the final cash flow statement. So now, we will start with the basic cash flow statement. Basic cash flow statement; and this is the statement as we have been preparing in the past. No change nothing; we say traditional cash flow statement. And if you look at this cash flow statement, then it is very simple to prepare very easy to prepare. And for this we will have to start.

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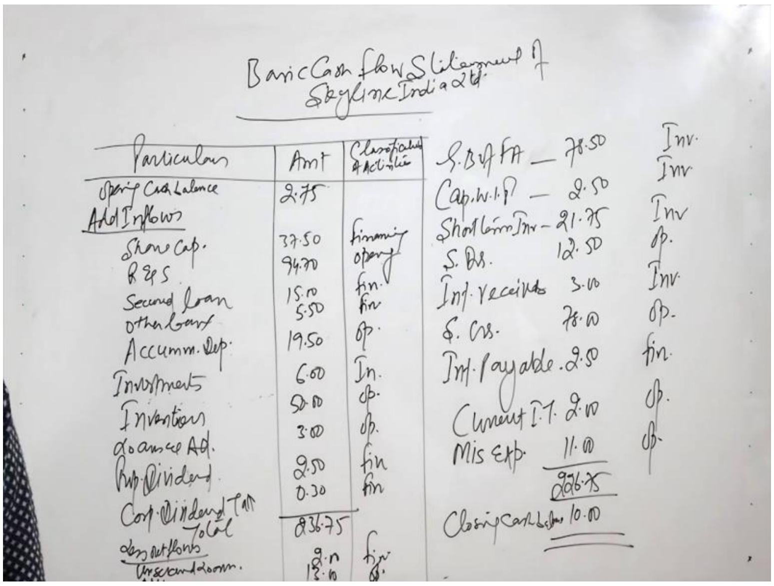

So it is very simple statement you can call it as. So, it is called as the basic cash flow statement of Skyline India limited; this is the basic cash flow Skyline India limited we are preparing. We have 4 columns or we can do with the 3 also these are the columns we are going to have here this is the 1, 2 then it is the 3; these are the 3 columns we are going to have. And here are the particulars or details, then it is the amount and it is the classification of the activities classification of activities. So, these are the 3 main columns. So, here we have to take the particular amount and we have to classify from where the cash is flowing in or the cash is flowing out what are the sources of cash inflow and what are the activities where the cash is flowing out. So, we are starting with the opening cash balance.

So, what was the opening cash balance here? So, if we check this opening cash balance we are preparing the balance sheet on say for the year ending on 31st March 2007. So, we will be preparing the cash flow statement for that date itself. So, along with the balance sheet and profit and loss account now we will have to prepare the cash flow statement also. So, if you look at the cash flow statement and we start with opening cash balance. So, it must be somewhere in the current assets. So, we are here are the current assets and he here are the cash and bank balance is it is 10,00,000 here and in the beginning we started the process with the 2.75 lakhs. So, opening cash balance was amount is 2.75 lakhs. When we started with this with balance of 2.75 lakhs then during the year how the cash has come in from where the cash has flown in and where the cash has flown out now we will try to find out those sources and avenues.

So, now we will be talking, we will go back to the balance sheet and say the first part of the balance sheet and if you see; if you start from the top. So, let us check that from where the cash is flowing in and where the cash is flowing out means too. So, we will write here add inflows add inflows add inflows. So, if you take the inflows here inflows first we start with the share capital. So, look at what was the share capital in the previous year's end 62.50 lakhs and now it has become 1,00,00,000. It means share capital worth rupees 37.5 lakhs has been issued more in the current year. So, cash has share capital and this is 37.50 and this activity is called as the financing activity or on account of financing source the cash has flown in this is called as financing; this is called as financing.

Next is the reserve and surplus. So, our reserve and surplus which was 69,00,000, in the beginning of the previous year means the at the end of the previous year now in the same at the end of the current year it has become 163.70 lakhs. So, it means on account of reserve and surplus also there is a inflow and the reserve and surplus has increased. So, what is the difference? But how much amount has flown in that is 94 point; it is say I think 3 0; 94.70, yes, 94.70 worth of lakh of rupees 70 have come in. But what is the reserve and surplus source of reserve and surplus is the profits and profit is the operating income. So, it is basically operating, it is operating, we simple have to put here and then we will prepare the detailed cash flow statement, then we talk about the loan fund secured loans it means it was 0 here, previous year, but this year we have 15,00,000 it means 15,00,000 have flown in.

So, write here that yes that is a secured loan is the other source; secured loans is the other source of inflow and in this secured loans we have bought the cash worth rupees 15,00,000 this year. So, it is secure loans worth rupees 15,00,000. So, it means it is a inflow and when we get the money on account of the loans coming in and that is 15,00,000. So, it is basically which activity it is financing.

After that we go to the other loans; other loans have also gone up from the 44,00,000 to the 49.50 lakhs. So, the other loans have others; other loans have also become increased by 4.5; 5.5 amount that is 5.5 here it is. So, loans and loans are also the financing activity they are also financing activity then we talked about the next thing is the loans are over deferred tax liabilities; deferred tax liabilities have come down from 45 to 32, it means the liabilities when we pay the liabilities the funds are flowing out. This again in one standard rule we have to follow and you have to learn that when any asset there is a increase in the asset it is the outflow of the funds.

Decrease in the assets is the inflow of the funds, similarly increase in the liabilities is a inflow of the funds and decrease in the liabilities is the outflow of the funds. So, here deferred tax liabilities when it is decrease from 45 to 32, it means the funds have flown out. So, we will count that at the time of the say taking to account the outflows. Now we talk about the next part and that next part is the; say we talk about say your assets and when in case of the assets if you talk about the gross block of the assets it means assets were 95.50 lakhs previous year, current year it is 174; 174 lakhs, it means assets have increased. So, it means there is outflow, not the inflow similarly accumulated depreciation; depreciation accumulated, depreciation is always inflow so because it is a non cash expense.

So, on the one side be take out the depreciation amount from the P and L account and it is increasing the cash balance, we keep it in the bank. So, it means it is 53,00,000 to 72.50 lakhs. So, depreciation has increased. So, it is an inflow. So, it is the accumulated depreciation is has is it as increase the inflow. So, accumulated depreciation is by the total amount of this is 19.50 lakhs and here it is operations, this is the operating activity depreciation is the operating activity, then we have to talk about the next thing that is capital work in progress, it has also increased. So, it means capital work in progress also cause; the outflow nor the inflow.

Now let us go to a next level that is the investments, now investments are they were 105 in the previous ,year this year they have become 99, it means investments assets have come down it means the funds have flown in. So, investments on account of investments; the inflow has occurred and if you say long term investments how much is the difference? It is 6 lakhs and this is investing activity.

Investments are investing activity then we talk about next assets we see that in case of the short term investments have increased. So, cash has flown out long term have decreased cash has flown in and short term investments have increased. So, cash has flown out. Now we talk of the current assets and if we talk about the current assets first is the inventory; inventory has decreased from 78,00,000 to 28,00,000. It means there is a inflow.

So, inventories are how much? I think it is 50,00,000 and this is which activity it is operating activity then is the loans and advances, we talk about the next in debtors; debtor have increased it means increase in the asset is the outflow of the funds, then we talk about the cash and bank balance is not to take because we are preparing a cash flow statement interest receivable has increased it means it is not inflow. So, say when you talk about the interest compound or interest part we see that is only receivable. So, liabilities have increased, but not received as such.

Then we talk about the loans and advances yes loans and advances have decreased from fifteen to twelve it means it has caused inflow of the cash. So, it is the loans and advances loans and advances and if you take the loans and advances worth of 3,00,000. The funds have flown in and this is called as the operating inflow. Now we talk about the next thing is that is what is the other source of income we inflow. Let us talk about the liabilities, sundry creditors have gone down it means we have made the payment. So, funds have flown out interest payable has come down it means interest has been paid. So, funds have flown loan.

So, it means provisions current income tax has come down tax is paid dividend yes dividend part is important here dividend has increased from 12.5 in the previous to the 15, it means there is a inflow on account of dividend and that is to the extent of that is proposed dividend proposed dividend and this is to the extent of 2.50 lakhs. So, this is the this is this activity called as financing activities dividend is paid to the on account of share capital this is called as a financing activity and last is the corporate dividend tax corporate dividend tax has also increased.

So, we made the provision from the profit and loss account, but actually not paid the tax. So, this money the firm is using this is inflow of the cash. So, it is a corporate dividend tax corporate dividend tax and this amount is how much? 0.30, this is the corporate dividend tax this is also financing 0.30. So, I think these all we have taken into account we have seen and if you talk about this. So, this balance works out as total of initial cash balance plus inflows. So, this is 236; 236.75 lakhs of the balance.

We have now the balance and now we will go for preparing the cash same means next part we will continue with the statement and take into consideration the outflows less now less outflows less outflows. So, the first source of cash outflows is what will go back and we will see that what is the source of the cash outflow and the cash outflow here it is when we have taken the share capital it is the inflow surplus; surplus reserve and surplus is the inflow similarly we talk about the secured loans is a inflow and other is also inflow then unsecured short term yes short term loans have been paid.

So, it means short term loans have been paid it means this is from 8,00,000 to 6,00,000. So, it means first is the unsecured loans we have paid unsecured loans. So, if you say how much unsecured loans we have paid that is 2,00,000; worth of 2,00,000 and this is the financing activity that the next is loans we have talked about then is the deferred tax liabilities they have come down from the 45 to 32, it means worth of 13,00,000 deferred tax liabilities have come down deferred tax liabilities and they have come down by 13,00,000. So, it means this is again the financing or operating activities this is the taxes relating to the operation. So, this is the operating activity we will continue with the statement.

So, deferred tax liabilities after this is a gross block of the assets gross block of assets means that is the assets have increased from 95.50 to 174. So, it means gross block is gross block of fixed assets and that is how much we are putting here this amount is we are putting here and this is 95 point, sorry. This difference is gross block of the fixed assets is 78.5 and it is on account of say investing activities gross block then we talked about the capital work in progress and the capital work in progress has also increased from 45 to 106.5. So, this is the capital work in progress sorry, 2.5 to 4. So, it means there is an increased outflow that is the capital work in process and this is by 2.5 capital work in process that is by 2.5 and this is the called as the investing outflow capital work in process.

Now, let us move further to the other parts and if you move further to the other parts then let us check the other sources outflow investments have come down long term short term have increased. So, it is the short term investment it is short term investment and it has increased. So, when you talk about the short term investment it has increased by 21.75 and this is called as investing activity this is called as investing activity then we talk about the others say long term investments have come down. So, it was inflow now come to the current asset inventory has caused the inflow sundry debtors have caused the outflow. So, it is sundry debtors; sundry debtors and sundry debtors if you talk about worth of 12.5 lakhs they have gone up. So, it is operating then we talk about the next thing that is the cash and bank balance not to be taken interest receivable is 2 to 3. So, because of the interest receivables 3 is the difference asset has increased interest receivable by 3,00,000. It has caused the outflow, but it is the; you call it as a say investing activity interest is the investing activity then we talk about the sundry debtors say sundry creditors.

Now, we have dealt with the inventory sundry debtors interest and loans and advances we have already taken as inflow now we talk about the current liabilities and current liabilities are sundry creditors have decreased it means we have paid the current liabilities. So, once the current liabilities are reducing it means they are causing the outflow and how much is the say sundry creditors the outflow is seventy how much it is sundry creditors is from 94 to 16, it is 78. So, it is sundry creditors 78,00,000. This is the sundry creditor it means it is operating it is a 78,00,000 operating cash flows and then we talk about the interest payable we talk about the interest payable interest payable is decreased it means interest has been paid interest payable liability has decreased. So, it means is it has caused the outflow of the funds. So, interest payable is this much and if you talk about the interest payable part it is by 2.5 lakhs it is the financing outflow.

Now we talk about the next thing is that is the provisions will be taking current income tax; provisions it is 5 to 3 net of the tax paid. So, it means it has caused the outflow. So, it means it was closing was 5, it has become 3. So, it is the current income tax payable. So, current income tax has been paid this is to the extent of 2,00,000. So, it is operating outflow then we talk about the proposed dividend proposed dividend has increased. So, it is a source of funds and corporate dividend tax. So, it means nothing else is there corporate dividend tax is also the inflow we have increased it.

So now, we talk about the last item that is a miscellaneous expenditure. Miscellaneous expenditure has increased from 5 to 16. So, miscellaneous expenditure is again a outflow; miscellaneous expenditure is again a outflow and that is why 11,00,000. So, this is called as operating activity or the operating on to the operating expenditure and this is 11. So, now, if you talk about this, this works out as the say earlier we have 236.75 and if you take the total of this that is 226.75. So, you can easily find out closing cash balance;

closing cash balance is 10,00,000; closing cash balance is the 10,00,000 and this is the closing balance given here in the say balance sheet. If you look at the cash and bank balances here it was 2.75 lakhs in the previous year at the end of the previous year it was 2.75 lakhs, and in this year the closing cash balance is the 10,00,000.

So, it means we have verified that yes it is correct that whatever the balances are shown cash balance is shown closing cash balance is shown in the say balance sheet that is verifiable. We have identified here by preparing the basic cash flow statement that yes this was this was the opening cash balance 2.75 these are the different sources from where the cash has flown in both long term and short term. Now finally we have found out that were the cash has flown out and this all the documentary evidence is there with the firm. So, we know that it is there and now the cash is closing cash balance is 10 lakhs. This is in the balance sheet also, this must be in the bank account also, this can be verified from the bank passbook everywhere and there is no point to doubt that the cash position of the form is not clear.

But you see that why now the final cash flow statement is required. If you look at we have no classified activities here also from where the cash has flown in and flown out, but it is not clear. So, we have to do is that we have to prepare a proper final cash flow statement that say how much cash is from operations. First we will talk about the operations then we will talk about the investing flows and then the financing flows and we will have to take into consideration for that this additional information also that is this we have to take into account and verify and prepare the final cash flow statement.

And the basic another difference is that the basic cash flow statement is started with the opening cash balance of the current year, whereas the final cash flow statement is started with the profit maybe we say that for final cash flow statement start with the profit. So, profit figure and in the profit figure we follow the say even you can call it is backtracking process. Profit before tax and extraordinary incomes we take that into account and then we add up some say you can call it as say investing and financing outflows we add it back and then we subtract it at the point with when will be talking about the investing and financing outflow, so then it is called as the indirect method of preparing the final cash flow statement.

Indirect means first you take the profit and you adjust the profit and then you try to find out that in this total profit how much is the cash profit, how much has come in from the operations, how much has coming from the financing, how much has come in from the investing, and then we will have to justify and we will have to show that; what is the position of operations, what is the position of investing activities, and what is the position of financing activities.

Now, the next part is we will be learning to prepare the final cash flow statement along with the further analysis that I will be doing in the next part of discussion; means in the next lecture.

Thank you very much.