

ACCOUNTING STANDARD – 3

CASH FLOW STATEMENTS

Applicability of AS 3

The applicability of Cash flow statement has been defined under the Companies Act, 2013. As per the definition in the act, a financial statement includes the following:

- i. Balance sheet
- ii. Profit and loss account / Income and expenditure account
- iii. Cash flow statement
- iv. Statement of changes in equity
- v. Explanatory notes

Thus, cash flow statements are to be prepared by all companies but the act also specifies a certain category of companies which are exempted from preparing the same. Such companies are *One Person Company (OPC)*, *Small Company* and *Dormant Company*.

- ◆ *OPC* means a company which has only one single person as its member.
- ◆ A *Small Company* is a private company with a maximum paid up capital of Rs. 50 lakhs and a maximum turnover of Rs. 2 crores.
- ◆ A *Dormant Company* is an inactive company which is formed for some future projects or only to hold an asset and has no significant transactions.

Cash and Cash Equivalents

Cash equivalents are held by an enterprise for meeting its short-term cash commitments instead of the purpose of investment or such other purposes. For investments to qualify as cash equivalents:

1. An investment must be **easily convertible into cash** and
2. Must be subject to a **very low level of risk** with respect to changes in its value

Hence, an investment would qualify to be a cash equivalent only when such an **investment has a short maturity of three months or less** from its acquisition date.

AS 3 Cash Flow Statements states that cash flows should exclude the movements between items which forms part of cash or cash equivalents as these are part of an enterprise's cash management rather than its operating, financing and investing activities.

Cash management consists of the investment of excess cash in the cash equivalents.

Presentation of Cash Flow

A cash flow statement must depict the cash flows within the period classifying them as

A. Operating activities

B. Investing

C. Financing activities

Companies must prepare and present cash flows from operating, financing as well as investing activities in such manner that is apt to their business.

Grouping the activities provide information which enables the users in assessing the impact of such activities on the overall financial position of an enterprise and also assess the value of the cash and cash equivalents.

A. Operating Activities

Cash flows from operating activities predominantly result from the **main revenue-generating activities of an enterprise.**

For example:

- (i) Cash received from the sale of goods and services
- (ii) Cash received in form of fees, royalties, commissions and various other revenue forms
- (iii) Cash paid to a supplier of goods and services

B. Investing Activities

Cash flows from investing activities represent outflows are made for resources intended for generating cash flows and future income.

For instance:

- (i) Cash paid for acquiring fixed assets
- (ii) Cash received from disposal of fixed assets (including intangibles)
- (iii) Cash paid for acquiring shares, warrants or debt instruments of other companies and interests in JVs

C. Financing Activities

Financing activities are those which brings **changes in composition and size of owner's capital and borrowings** of an enterprise.

For instance:

(i) Cash received from issuing shares or other similar securities

(ii) Cash received from issuing loans, debentures, bonds, notes, and other short-term or long-term borrowings

(iii) Cash repaid on borrowings

Cash flow from operating activities

A company must report its cash flows from operating activities using:

1. **Direct method** – Where all the major classes of cash receipts and cash payments are presented; or

2. **Indirect method** – Where the **net profit or net loss** is adjusted for:

a) Effects of transactions that are non-cash in nature such as depreciation, deferred taxes, provisions, etc.

b) Accruals or deferrals of future or past operating cash proceeds or payments

c) Any expense or income related to financing or investing cash flows

Cash Flow from Investing and Financing Activities

A company must separately record all the major classes of cash receipts and cash payments which arises from financing and investing activities, barring the ones which need to be reported on the net basis.

A. Cash flow on Net Basis

Cash flows which arise from below-mentioned operating, financing or investing activities might be reported on a net basis:

(i) Proceeds and payments in cash on behalf of a client where cash flows reflect the activities of such client rather than that of the company itself

(ii) Proceeds and payments in cash for items where the amounts are huge, turnover is quick, and maturities are short

Cash flows which arise from each of the below-mentioned activities of any financial enterprise might be reported on the net basis:

(i) Proceeds and payments in cash for acceptances and repayments of deposits having fixed maturities

(ii) Placement and withdrawal of deposits from other financial enterprises

(iii) Loans and cash advances are given to clients/customers and repayment of such loans and advances

B. Foreign Currency Cash Flows

Cash flows that arise from the transactions in the foreign currencies must be recorded in the company's reporting currency by using the below method:

Foreign currency amount * FX rates between the reporting and foreign currency at the date of cash flow.

A rate which approximates actual rate might be used in case the outcome is largely the same as it would have been if the rate at the date of cash flows was used.

The impact of changes in the exchange rate on cash and cash equivalents which is held in the foreign currencies must be reported as a distinct and separate part of the reconciliation of changes in the cash and cash equivalent during the relevant period.

Extraordinary Items, Dividends & Interests

The cash flows related to the extraordinary items must be categorized as arising from operating, financing or investing activities as apt and disclosed distinctly.

Cash flows from dividends and interest received and paid must be separately disclosed. **Cash flows which arise from dividends and interest received and paid in the case of financial enterprises must be categorized as cash flows from operating activities.**

For other enterprises, cash flows which arise from interest paid must be categorized as cash flows from the financing activities whereas dividends and interest received must be categorized as cash flows from the investing activities. Any dividends paid must be categorized as cash flows from the financing activities.

Taxes on Income

Cash flows which arise from taxes on income must be disclosed separately and must be reported as cash flows from the **operating activities** except if they could be explicitly related to investing and financing activities.

Acquisitions and Disposal of Business Units including Subsidiaries

The aggregate cash flows which arise from acquisition and from the disposal of business units including subsidiaries must be shown as **investing activities and reported separately.**

Enterprises must present, in total, with respect to both the acquisitions and disposals of other business units including subsidiaries within the period the followings:

(a) Aggregate purchase or disposal value

(b) The amount of purchase or disposal value which is discharged by way of cash and cash equivalents

Non-Cash Transactions

Financing and investing transactions which don't require cash or cash equivalents mustn't be included in the cash flow statement. Those transactions must be presented elsewhere in financial statements in a way which gives relevant information about such financing and investing activities.

Disclosure

Enterprises must disclose, along with management commentary, the amount of substantial cash and cash equivalents held by an enterprise which isn't available for use.

Commitments that may arise from discounted bills of exchange and other similar obligations that are undertaken by an enterprise are typically disclosed in financial statements by means of notes, even in case the probability of loss is remote.

Question 1

Classify the following activities as

- (a) Operating Activities,
- (b) Investing Activities,
- (c) Financing Activities
- (d) Cash Equivalents.
- (a) Purchase of Machinery.
- (b) Proceeds from issuance of equity share capital
- (c) Cash Sales.
- (d) Proceeds from long-term borrowings.
- (e) Proceeds from Trade receivables.
- (f) Cash receipts from Trade receivables.
- (g) Trading Commission received.
- (h) Purchase of investment.
- (i) Redemption of Preference Shares.
- (j) Cash Purchases.
- (k) Proceeds from sale of investment
- (l) Purchase of goodwill.
- (m) Cash paid to suppliers.
- (n) Interim Dividend paid on equity shares.
- (o) Wages and salaries paid.
- (p) Proceed from sale of patents.
- (q) Interest received on debentures held as investment.
- (r) Interest paid on Long-term borrowings.
- (s) Office and Administration Expenses paid
- (t) Manufacturing Overheads paid.
- (u) Dividend received on shares held as investments.
- (v) Rent Received on property held as investment.
- (w) Selling and distribution expense paid.
- (x) Income tax paid
- (y) Dividend paid on Preference shares.
- (z) Underwritings Commission paid.
- (aa) Rent paid.
- (bb) Brokerage paid on purchase of investments.

- (cc) Bank Overdraft
- (dd) Cash Credit
- (ee) Short-term Deposits
- (ff) Marketable Securities
- (gg) Refund of Income Tax received.

Solution

- (a) Operating Activities: c, e, f, g, j, m, o, s, t, w, x, aa & gg.
- (b) Investing Activities: a, h, k, l, p, q, u, v, bb & ee.
- (c) Financing Activities: b, d, i, n, r, y, z, cc & dd.
- (d) Cash Equivalent: ff.

Question 2 Classify the following activities as per AS 3 Cash Flow Statement:

- (i) Interest paid by financial enterprise
- (ii) Tax deducted at source on interest received from subsidiary company
- (iii) Deposit with Bank for a term of two years
- (iv) Insurance claim received towards loss of machinery by fire
- (v) Bad debts written off

Solution

- (i) Interest paid by financial enterprise
Cash flows from operating activities
- (ii) TDS on interest received from subsidiary company
Cash flows from investing activities
- (i) Deposit with bank for a term of two years
Cash flows from investing activities
- (ii) Insurance claim received against loss of fixed asset by fire
Extraordinary item to be shown as a separate heading under 'Cash flow from investing activities'
- (iii) Bad debts written off
It is a non-cash item which is adjusted from net profit/loss under indirect method, to arrive at net cash flow from operating activity.

Question 3 Money Ltd., a non-financial company has the following entries in its Bank Account. It has sought your advice on the treatment of the same for preparing Cash Flow Statement.

- (i) Loans and Advances given to the following and interest earned on them:
 - (1) to suppliers
 - (2) to employees
 - (3) to its subsidiaries companies

- (ii) Investment made in subsidiary Smart Ltd. and dividend received
- (iii) Dividend paid for the year
- (iv) TDS on interest income earned on investments made
- (v) TDS on interest earned on advance given to suppliers

Discuss in the context of AS 3 Cash Flow Statement.

Solution

Treatment as per AS 3 'Cash Flow Statement'

- (i) Loans and advances given and interest earned
 - (1) to suppliers Cash flows from operating activities
 - (2) to employees Cash flows from operating activities
 - (3) to its subsidiary companies Cash flows from investing activities
- (ii) Investment made in subsidiary company and dividend received
Cash flows from investing activities
- (iii) Dividend paid for the year
Cash flows from financing activities
- (iv) TDS on interest income earned on investments made
Cash flows from investing activities
- (v) TDS on interest earned on advance given to suppliers
Cash flows from operating activities

Note:

Generally ICAI asks long questions on Cash Flow Statement so it is advised to you to attempt the questions from Chapter 4 Unit 2 of CA Inter (New Syllabus)



Student Notes:-

COVID-19

