1. Details of Module and its structure

Module Detail	
Subject Name	Accountancy
Course Name	Accountancy 04 (Class XII, Semester – 2)
Module Name/Title	Cash Flow Analysis – Part 3
Module Id	leac_20603
Pre-requisites	Basic knowledge of General Accountancy & Cash Account
Objectives	After going through this lesson, the learners will be able to understand: • Extra ordinary items & Taxes on Income & Gains • Investing & Financing Activities • Non Cash Transactions & Cash & cash equivalents
Keywords	Extraordinary items, Investing Activities, Financing Activities, and Accumulated Depreciation.

2. Development Team

Role	Name	Affiliation
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1. WHAT ABOUT EXTRAORDINARY ITEMS???

Extraordinary items are not the regular phenomenon as they are non-recurring in nature and hence Cash flows associated with these extraordinary items should be disclosed separately as whether they are arising from Operating, Investing or Financing Activities. It will enable the users to understand their Nature and Effect on the Present and Future Cash flows of an enterprise.

These can be item of Income or Expenses. Claims, Compensations, etc. on account of Damages, Losses, loss due to theft or earthquake or flood etc. come under this category.

Inflows are to be added & Outflows, if any, are to be deducted.

Examples of Extraordinary items:

(i) **Operating Activities**: Compensation paid to employees (Voluntary Retirement Scheme), Damages on account of Wrong quality of Goods, Late Delivery of Goods, etc.

(ii) **Investment Activities**: Claim received against damage of fixed assets due to earthquake

(iii) **Financing Activities**: Buy – back of Shares.

These things don't happen generally on regular basis. So, Extraordinary.

Taxes on Income and Gains

Taxes may be Paid on account of Income tax (Tax on Normal Business Profits), Capital gains (Tax on capital profits like Sale of an Asset / Investment), Corporate Dividend Tax (Tax on the amount distributed as Dividend to shareholders).

AS-3 requires that cash flows arising from above various kinds of taxes should be separately disclosed as follows:

*Tax on Normal Business Profits should be classified as Operating cash outflows.

*Dividend tax, should be classified as financing activity along with dividend paid.

*Capital gains tax on sale of fixed assets/ Investments should be classified Investing activities.

So, finally we reach at the end, i.e Cash from Operating Activity, Arrived.

Moving on then to Investing Activity, Investing Activities are the activities related to acquisition and disposal of the Long-term Assets and Other Investments, which are not included in cash & cash equivalents

These may be related to investing the Money in Fixed Assets, Investments OR regarding their Sales OR Anything related to Investments like Rent, Interest & Dividend Received. Rules to be the same. Inflows to be added. Outflow on account of Investments, to be deducted.

Examples of Cash Inflows from Investing Activities are:

(i) Cash receipts from disposal of fixed assets.

(ii) Cash receipts from disposal of Shares, Debentures (Investments) of other enterprises.

(iii) Cash receipts from the Repayment of Advances and Loans made to third parties (other than advances and loans of a financial enterprise, where it will be Operating Activity).

Examples of Cash Outflows from Investing Activities are:

(i) Cash payments to Purchase fixed assets. These payments include Rresearch and development costs and Cost of Self – constructed fixed assets.

(ii) Cash payments to acquire shares or debt instruments (Investment) of other enterprises.

(iii) Cash Advances and Loans made to third parties (other than advances and loans made by a financial enterprise, where it will be Operating Activity).

(iv) In case of hire purchase, amount paid for principal amount is an investing activity.

Financing activities. Activities which result in change in size and composition of owner's capital (Equity / Preference Share Capital in the case of a company) and Long term borrowings of the enterprise from others for the Business. All Inflow related to Issue of Shares, Debentures, Loans, etc. are to be added and while Repaying them, or when we pay Interest & Dividend on that, it will be Outflows.

Examples of Cash Inflows from Financing Activities are:

(i) Cash proceeds from issue of shares or other similar instruments.

(ii) Cash proceeds from issue of debentures, loans, bonds and other long – term borrowings.

(iii) Increase in **Bank Overdraft and Cash Credit (Although Short Term)

(iv) Interest on Calls in arrears is a cash flow from financing activities.

Examples of Cash Outflows from Financing Activities are:

(i) Cash repayments of the amounts borrowed.

(ii) Redemption of Debentures and Preference Shares.

(iii) Payment for Buy – back of Equity Shares.

(iv) Payments of dividends on Equity and Preference Shares.(ALWAYS FINANCING)

(v) Payments for Interest on Debentures and Loans.(For finance co.—Operating)

(vi) Decrease in **Bank Overdraft and Cash Credit (Although Short Term)

(vii) In case of hire purchase, amount paid as interest is a financial activity

Non-cash Transactions

As per AS-3, Cash Flows Statement must exclude those items that does not cause any movement in cash or cash equivalents. All those Investing and financing transactions that do not require the use of cash or cash equivalents should be excluded from Cash flow statement.

These transactions should be disclosed somewhere else in the financial statements in such a way that provide all the relevant and required information about these Investing and Financing activities. Hence, Assets which are acquired by issue of Shares / Debentures / Loans, etc. are not disclosed in cash flow statement as they are non-cash in nature.

So, No Cash Flow means No Recording

It's really simple. They are also excluded because these transactions are actually part of Cash Management Strategies of the Management.

Some Examples of Non-cash transactions are:

(i) Purchase of Asset against Shares or Debentures

(ii) Sale or Purchase of short – term marketable securities both being Cash & Cash equivalents.

(iii) Conversion of debentures into shares

(iv) Bonus Issue out of Reserves.

QUESTION 1. [CBSE PATTERN]

Classify the following transactions as Operating, Investing and Financing Activities for
(i) Financial Enterprise, and (ii) Non – Financial Enterprise.

1. Interest paid on Debentures
2. Dividend received on Shares
3. Sale of Investments
4. Interest received on Investments
5. Dividend Paid
6. Loans and Advances made
7. Receipt of Loans and Advances made
8. Commission paid on purchase of securities
9. Sale of Securities
10. Purchase of Securities

SOLUTION 1:

No. Transactions	Financial Enterprise	Non-Financial Enterprise
1. Interest paid on Debentures	Operating	Financing
2. Dividend received on Shares	Operating	Investing
3. Sale of Investments	Operating	Investing
4. Interest received on Investments	Operating	Investing
5. Dividend paid	Financing	Financing
6. Loans and Advances made	Operating	Investing
7. Receipt of Loans and Advances made	Operating	Investing
8. Comm. paid on purchase of securities	Operating	Investing
9. Sale of Securities	Operating	Investing
10. Purchase of Securities	Operating	Investing

QUESTION 2. [CBSE PATTERN]

State which of the following would result in inflow /outflow of Cash and Cash Equivalents:

1. Conversion of Debentures into Shares by a company.
2. Declaration of dividend.

3. Sale of Marketable Securities at profit.
4. Interest paid on Long term loan.
5. Depositing Cash into Bank.
6. Purchased machinery Rs. 1,00,000. Paid by Cheque.
7. Paid to creditors Rs. 90,000.
8. Converted Rs. 50,000 equity shares into 12% debentures.
9. Received cash Rs. 80,000 from Trade Debtors.
10 Issued equity shares Rs. 5,00,000 for cash.
11 Building Purchased by issue of shares.
12 Furniture costing Rs. 5,000 sold for Rs. 10,000.
13 Depreciation on Plant & Machinery.
14 Issue of Bonus Shares.

SOLUTION 2:

No.	Effect on Cash Flow	Reason and Explanation
1.	No Flow	As Both items related to non – current items.
2.	No Flow	Declaration of Dividend mean that it has not been paid.
3.	Inflow	Movement between items of cash or cash equivalents, but more cash inflow, as at a profit.
4.	Outflow	Payment of cash to Lenders.
5.	No Flow	Movement between two items of cash or cash equivalents.
6.	Outflow	Cash and Cash Equivalents (Bank) decreased by Rs. 1,00,000.
7.	Outflow	Cash and Cash Equivalents decreased by Rs. 90,000.
8.	No Flow	As Both items are related to non – current items.
9.	Inflow	Cash and Cash Equivalents increased by Rs. 90,000.
10.	Inflow	Cash and Cash Equivalents increased by Rs. 5,00,000.
11.	No Flow	As Both items are related to non – current items.
12.	Inflow	Cash and Cash Equivalents increased by Rs. 10,000.
13.	No Flow	No involvement of Cash and Cash Equivalents. Non-Cash
14.	No Flow	No involvement of Cash and Cash Equivalents. Non-Cash

QUESTION 3. [CBSE PATTERN]

Classify the following transactions into

(a) Operating Activities, (b) Investing Activities and (c) Financing Activities

(i) Commission received

(ii) Issue / Redemption of Debentures

(iii) Increase / Decrease in Bank Overdraft

(iv) Increase / Decrease in Cash Credit

(v) Purchase / Sale of goodwill

(vi) Interest paid on 12% Debentures by non-financial enterprise

(vii) Purchase / Sale of machinery

(viii) Interim Dividend paid on Equity Shares

(ix) Interest received on Investment.

SOLUTION 3:

	Transactions	**Activity**
(i)	Trading Commission received	Operating
(ii)	Issue /Redemption of Debenture	Financing
(iii)	Increase / Decrease in Bank Overdraft	Financing
(iv)	Increase / Decrease in Cash Credit	Financing
(v)	Purchase / Sale of goodwill	Investing
(vi)	Interest paid on 12% Debentures by non-financial enterprise	Financing
(vii)	Purchase / sale of machinery	Investing
(viii)	Interim Dividend paid on equity shares	Financing
(ix)	Interest received on Investment	Investing

CASH AND CASH EQUIVALENTS (SOME IMPORTANT OBSERVATIONS)

1. Preference shares of a company, purchased very shortly before their redemption (say before three months) can be treated as cash equivalents, if there is only an insignificant risk of failure to receive the amount on maturity.
2. Short term highly liquid investments which can be converted immediately into known amounts of cash and they present insignificant risk of any change in values
2. Bank Overdraft and Cash Credit are short term borrowings but for the purpose of preparing Cash Flow Statement it shall be treated as part of Financing Activities.
3. Cash, Bank, Marketable securities, Current Investments, Treasury Bills, Commercial Papers, Preference Shares (3 month maturity), Short term deposits in Bank & Short term Investment are included here.
4. Current Investments, if nothing specified, always treated as Marketable Securities (Cash & cash equivalent)

Let us now discuss some important adjustments in detail before moving on to FULL Questions.

1. PROVISION FOR DOUBTFUL DEBTS

There are two alternative treatments for Provision for Doubtful Debts. The net effect is same in both the treatments.

Treatment 1.

Subtract opening provision from opening debtors and closing provision from closing debtors. Therefore, only net change in Debtors is shown as Change in working capital item.

Treatment 2.

Show the effect of increase or decrease in Debtors and Provision for Doubtful Debts separately. Debtors to be treated as Working capital change and Provision, if given in Current Liability, to be treated as Working capital change. And, if given separately on Liability side, treat as non-cash item and ADD, if increased & DEDUCT, if decreased.

2. INCOME TAX PAID (NET OF REFUND)

The Income Tax paid during the year is an operating activity as per AS – 3 (Revised). So, tax paid (net of refund) is deducted from Cash from Operating Activities.

But Corporate Dividend tax is classified as financing activity along with dividend paid.

And Capital gains tax on sale of fixed assets/ Investments classified as investing activities.

3. PROVISION FOR TAX

Provision for Tax is an estimate of tax liability for a given year. So, The provision for tax made during the year, being a Non – Cash Expense, it is Added back to the current year's profit. Now, there can be TWO CASES.

CASE A. When both Opening and Closing Balances are given:

If both opening and closing balances of Provision for Tax given and no other information:

- Opening Balance is treated as Tax paid during the year. Recorded as an Outflow of cash under Cash Flow from Operating Activities (CFOA).
- Closing balance treated as 'Tax Provision Made' in current year. Added to current year's profit.

CASE B. When both Opening and Closing Balances are given and Additional Information is also given:

In that case, always prepare Provision for Tax Account, as shown below:

Dr. FORMAT OF PROVISION FOR TAX ACCOUNT Cr.

Particulars	Amt	Particulars	Amt
To Bank A/c (Tax Paid)		By Balance b/d (Opening Balance)	
To Balance c/d (Closing Balance)		By Statement of Profit and Loss A/c (Provision made during the year)	

Let us do few examples on this point.

EXAMPLE 1. The following information is given about Provision for Tax of a Company:

Particulars	Opening Balance (Rs.)	Closing Balance (Rs.)
Provision for Tax	40,000	60,000

Tax Paid during the year Rs. 35,000.

SOLUTION 1:

Dr. PROVISION FOR TAX ACCOUNT Cr.

Particulars	Amt.(Rs.	Particulars	Amt.(Rs
To Bank A/c (Tax Paid)	35,000	By Balance b/d (Opening Balance)	40,000
To Balance c/d (Closing Balance)	60,000	By Statement of Profit and Loss A/c **(Bal. Fig.: Provision)**	**55.000**
	95,000		1,55,000

So, we got 55,000 as the balancing figure as the provision made during the year.

Rs.35,000 Payment Shown as Deduction under Cash Flow from Operating Activities

Rs.55,000 Added back to Current Year's Profit as it is not a payment (Non-cash item).

EXAMPLE 2. The following information is given about Provision for Tax of a Company:

Particulars	Opening Balance (Rs.)	Closing Balance(Rs.)
Provision for Tax	40,000	60,000

Provision for Tax made during the year Rs. 70,000.

SOLUTION 2:

Dr. PROVISION FOR TAX ACCOUNT Cr.

Particulars	Amt.(Rs	Particulars	Amt.(Rs.
To Bank A/c (Bal. Fig. Tax Paid)	35,000	By Balance b/d (Opening Balance)	40,000
To Balance c/d (Closing Balance)	60,000	By Statement of P/LA/c (Provision made during the year)	70.000
	1,10,000		1,10,000

So, we got 35,000 as the balancing figure as Tax paid during the year.

Rs.35,000 Payment Shown as Deduction under Cash Flow from Operating Activities

Rs.70,000 Added back to Current Year's Profit as it is not a payment (Non-cash item).

IMPORTANT OBSERVATIONS

If Taxes can be specifically identified with Financing / Investing Activities, in such a case, Taxes will be dealt in the Cash Flow of Financing or Investing Activity. For example,

- If a Building / Capital Asset is sold and the company earns gain (known as Capital Gains in Income Tax Act), then tax on such gains (Capital Gains Tax) is shown under Investing Activity.
- Similarly, if Dividend Distribution Tax (tax on dividend paid by the company), it will be shown under Financing Activity.

4. CHANGES IN THE VALUE OF FIXED ASSETS (ANALYSIS)

CASE A. No Additional Information Given

Increase in the value of Fixed Assets in comparison to previous year is taken as Purchase of Fixed Assets and is recorded as an outflow of Cash and decrease in the value of Fixed Assets in comparison to previous year is taken as sale of Fixed Assets and is recorded as an inflow of Cash under Investing Activities.

CASE B. Additional Information Given

Then the following accounts are to be prepared **generally**, depending upon the kind of information given in the question:

1. When Fixed Assets are shown at the written down value in the Balance Sheet, and the Balance Sheet does not have an item of Accumulated Depreciation (or Provision for Depreciation

Only Fixed Assets Account is prepared as depreciation for the current year is credited to the Fixed Assets Account.

Dr. FORMAT OF FIXED ASSETS ACCOUNT (written down value) Cr.

Particulars	Amt.	Particulars	Amt.
To Balance b/d		By Bank A/c (Sale)	
To Bank A/c (Purchase)		By Statement of P /L A/c (Loss on sale)*	
To Statement of P/LA/c (Profit on sale)*		By Depreciation A/c (Dep. for year)	
		By Balance c/d	

*Either Profit OR Loss will appear.

IMPORTANT OBSERVATIONS

1. Purchase of Fixed Asset: Outflow of Cash under Investing Activities.
2. Sale of Fixed Assets: Inflow of Cash under Investing Activities.
3. Treatment of Depreciation of Current Year: Depreciation does not involve payment in cash. So, it is added back (Non-cash item) to Net Profit before Tax and Extraordinary Items to calculate Cash Flow from Operating Activities.
4. Profit or Loss on Sale of Fixed Assets: Loss on sale is added back to Net Profit before Tax and Extraordinary Items and Profit on sale is subtracted, both being Non- operating items.

Let us understand this point with the help of an Example.

EXAMPLE 3.

From the following information, calculate machinery purchased during the year.

Particulars	31.03.2020 (Rs.)	31.03.2019 (Rs.)
Machinery	6,00,000	5,00,000

Additional Information: During the year, a Machinery having book value Rs. 80,000 was sold at a loss of Rs. 10,000 and depreciation charged on Machinery (Current year) was Rs. 40,000.

SOLUTION 3:

Dr. MACHINERY ACCOUNT Cr.

Particulars	Amt. (Rs.)	Particulars	Amt (Rs.)
To Balance b/d	5,00,000	By Bank A/c (Sale)	70,000
To Bank A/c (Purchase) (Bal Fig.)	2,20,000	By Statement of P/L A/c (Loss)	10,000
		By Depreciation A/c	40,000
		By Balance c/d	6,00,000
	7,20,000		7,20,000

So, when we put all the given information in the Account, we get a balancing figure on the debit side, which is purchase of Asset, Rs. 2,20,000. Similarly, if any other information is missing and this information is given, we can find that also.

2. When Fixed Assets are shown at Original Cost in the Balance Sheet.

Fixed Assets Account and Accumulated Depreciation Account is prepared as depreciation for the current year is NOT credited to the Fixed Assets Account in this case.

Dr. FIXED ASSETS ACCOUNT (AT COST) Cr.

Particulars	Amt.(Rs.)	Particulars	Amt. (Rs.)
To Balance b/d		By Bank A/c (Sale Price)	
To Bank A/c (Purchase)		By Statement of P/L A/c (Loss)*	
To Statement of P/L A/c (Profit)*		By Accumulated Depreciation A/c (On Sold Asset- till date of sale)	
		By Balance c/d	

*Either Profit OR Loss will appear.

Dr. ACCUMULATED DEPRECIATION ACCOUNT Cr

Particulars	Amt. (Rs)	Particulars	Amt.(Rs
		By Balance b/d	
To Fixed Asset A/c (Acc. Dep. on Asset sold)		By Statement of Profit and Loss A/c (Current Year Depreciation)	
To Balance c/d			

Let us understand this point with the help of an Example.

EXAMPLE 4.

From the following information, calculate machinery purchased / sold under the heading “Cash Flow from Investing Activities”.

Particulars	31.03.2020 (Rs.)	31.03.2019 (Rs.)
Machinery (At Cost)	5,00,000	3,00,000
Accumulated Depreciation	1,10,000	80,000

Additional Information: During the year, a machine costing Rs. 70,000 with its accumulated depreciation of Rs. 45,000 was sold at a profit of 20%.

SOLUTION 4:

Dr. MACHINERY ACCOUNT Cr.

Particulars	Amt. (Rs.)	Particulars	Amt. (Rs.)
To Balance b/d	3,00,000	By Accumulated Depreciation	45,000
To Statement of P/LA/c (Profit)	5,000	By Bank A/c (Sale)	30,000
To Bank A/c (Bal. Fig: Purchase)	2,70,000	By Balance c/d	5,00,000
	5,75,000		5,75,000

Dr. ACCUMULATED DEPRECIATION ACCOUNT Cr.

Particulars	Amt. (Rs.)	Particulars	Amt.(Rs.)
To Machinery A/c(Transfer)	45,000	By Balance b/d	80,000
To Balance c/d	1,10,000	By Statement of Profit and Loss A/c (Bal. Fig: Current Year)	75,000
	1,55,000		1,55,000

So, when we put all the given information in the Relevant Accounts, we get a balancing figure on the debit side, which is purchase of Asset, Rs. 2,70,000. Net Investing Activities will be Inflow = Rs. 30,000 & Outflow = Rs. 2,70,000. So, Net +30,000- 2,70,000= 2,40,000. Also, we are able to calculate Depreciation for the year Rs. 70,000 in Accumulated Dep. A/c.

Alternatively, Machinery Account & Machinery Sold Account can be shown separately:

Dr. MACHINERY ACCOUNT (AT COST) Cr.

Particulars	Amount	**Particulars**	Amount
To Balance b/d	3,00,000	By Machinery Sold A/c (Cost)	70,000
To Bank (Purchase) (Bal. Fig.)	2,70,000	By Balance c/d	5,00,000
	5,70,000		5,70,000

Dr. MACHINERY SOLD ACCOUNT Cr

Particulars	Amount	Particulars	Amount
To Machinery A/c	70,000	By Bank A/c (Sale of Machine)	30,000
To Statement of P/L	5,000	By Accumulated Dep. A/c	45,000
	75,000		75,000

Accumulated Depreciation account will remain the same, of course.