KAMARAJ COLLEGE

SELF FINANCING COURSES

(Reaccredited with "A+" Grade by NAAC)

(Affiliated to Manonmaniam Sundaranar University, Tirunelveli.)

THOOTHUKUDI - 628 003

STUDY MATERIAL FOR
B.COM CORPORATE SECRETARYSHIP

MANAGEMENT ACCOUNTING

VI - SEMESTER

ACADEMIC YEAR 2022-23

PREPARED

BY,

DEPARTMENT OF COMMERCE (SF)

KAMARAJ COLLEGE,

THOOTHUKUDI.

III B. COM (VI SEMESTER) – UNDER CBCS
PART III – MAJOR CORE -18
MANAGEMENT ACCOUNTING

Objective:

To enable the students to know the importance of management accounting and its concepts.

Unit I

Management accounting – Definition – Objectives – Nature – Scope – Merits and limitations – Differences between management accounting and financial accounting – Financial statement analysis – Comparative statement – Common size statement – Trend percentage – Ratio analysis – Meaning – Classification – Liquidity, solvency, turnover and profitability ratios.

Unit II

Fund flow statement – Meaning – Preparation – Schedule of changes in working capital – Funds from operation – Sources and applications – Cash flow statement – Meaning – Difference between fund flow statement and cash flow statement – Preparation of cash flow statement as per AS3.

Unit III

Budget and Budgetary control – Meaning – importance and its Advantages – Preparation of purchase, production, production cost, sales, overhead cost, cash and flexible budgets.

Unit IV

Standard costing – Meaning, Advantages and its Limitations - Variance analysis – Significance - Computation of variances (Material and Labour variance only) - Marginal costing – CVP analysis – Break even analysis – BEP – Managerial applications – Margin of safety – Profit planning.

Unit V

Capital Budgeting – Meaning – Importance – Appraisal methods – Payback period –– Accounting rate of return - Discounted cash flow – Net present value – Profitability index – Internal rate of return.

UNIT - I
MANAGEMENT ACCOUNTING

INTRODUCTION

Financial accounting is concerned with recording transactions and preparing financial and other reports to be used internally by management and externally by investors, creditors, potential investors, and government agencies. Management accounting, on the other hand, is primarily concerned with providing information for use by people within the organization.

DEFINITIONS OF MANAGEMENT ACCOUNTING

1. Anglo-American Council on Productivity: "Management Accounting is the presentation of accounting information in such a ways as to assist management in the creation of policy and the day-to -day operation of an undertaking.
2. Robert N. Anthony: "Management Accounting is concerned with accounting information that is useful to management"
3. T.G. Rose: "Management Accounting is the adaptation and analysis of accounting information and its diagnosis and explanation in such a way as to assist management."
4. J. Batty: —Management Accounting is the term used to describe the accounting methods, systems and techniques which, coupled with special knowledge and ability, assist management in its task of maximizing profits or minimizing losses .
5. The Institute of Chartered Accountants of India: "Such of its techniques and procedures by which accounting mainly seeks to aid the management collectively have come to be known as management accounting."
6. The Institute of Cost & Works Accountants of India defines Management Accounting as "a system of collection and presentation of relevant economic information relating to an enterprise for planning. Controlling and decision making.''
7. The American Accounting Association: "Management Accounting includes the methods and concepts necessary for effective planning, for choosing among alternative business actions and for control through the evaluation and interpretation of performances."

OBJECTIVES OF MANAGEMENT ACCOUNTING

The primary objective of Management Accounting is to enable the management to maximize profits or minimize losses.The fundamental objective of management accounting provides information to the managers for use in planning, controlling operations, and decision making

Main purpose and objectives of management accounting may be summarized as under:

1. **Uses of Information**

The primary functions of management are the uses of information. It presents accounting information in a form that enables the management, investors, and creditors to analyze the financial statements.

2. Planning and Policy Formulation

Planning is deciding in advance what is to be done. It helps the management of ineffective planning. It provides costing and statistical data to be utilized in setting goals and formulating future policies.

3. Decision Making

All management work is accomplished by decision making.Decision making is defined as the selection of a course of action from among alternatives. It helps the management in decision-making. It uses accounting data to solve various management problems.Management accounting techniques like cost-volume-profit analysis, standard costing, budgetary control, capital budgeting, funds flow analysis, etc. Assist the management in arriving at the correct decision.

4. Motivating

Motivation means individuals need, desires, and concepts that cause him or her to act in a particular manner. Delegation serves as a motivation device because it increases the job satisfaction of employees and encourages them to look forward.By setting goals, planning the best and economic courses of action, and also by measuring the performances of the employees, it tries to increase their efficiency and, ultimately, motivate the organization as a whole.

5. Controlling

Management accounting helps management in controlling the performance of the organization. Actual performance is compared with operating plans, standards, and budgets, and deviations are reported to the management so that corrective measures may be taken.

6. Coordinating Operations

It helps the management in controlling the performance of the organization. Actual performance is compared with operating plans, standards, and budgets, and deviations are reported to the management so that corrective measures may be taken.

7. Reporting

One of the primary objectives of management accounting is to keep the management fully informed about the latest positions of the concern. The facilitate management to take proper and timely decisions. The object of management accounting is to provide data. It presents the different alternative plans before the management in a comparative manner. The performance of various departments is also regularly communicated to the top management.

8. Help in Organizing

Organizing is the process of allocating and arranging human and nonhuman resources so that plans can be carried out successfully.

NATURE OF MANAGEMENT ACCOUNTING

i. The following are the main characteristics of management accounting: Providing Accounting Information. Management accounting is based on accounting information. The collection and classification of data is the primary function of accounting department. The accounting data is used for reviewing various policy decisions. Management accounting is a service function and ft provides necessary information to different levels of management
ii. Cause and Effect Analysis. Financial accounting is limited to the preparation of profit and loss accounting and finding out the ultimate result. If there is a profit the factors directly influencing the profitability are also studied. So the study of cause and effect relationship is possible in management accounting.
iii. Use of Special Techniques and Concepts. Management accounting uses special techniques and concepts to make accounting data more useful. The techniques usually used include financial planning and analysis, standard costing, budgetary control, marginal costing, project appraisal, control accounting, etc. The type of technique to be used will be determined according to the situation and necessity.
iv. Taking important decisions: management accounting helps in taking various important decisions. It supplies necessary information to the management which may base its decisions on it.
v. Achieving of Objectives. In management accounting, the accounting information is used in such a way that it helps in achieving organizational objectives.

vi. No Fixed Norms Followed. In financial accounting certain rules are followed for preparing different accounting books. On the other hand, no specific rules are followed in management accounting

vii. Increase in efficiency: The purpose of using accounting information is to increase efficiency the concern. The efficiency can be achieved by setting up goals for each department or section.

viii. Supplies Information and not Decision. The management accountant supplies information management. The decisions are to be taken by the top management. It is only to guide and not to supply decisions.

ix. Concerned with Forecasting. The management accounting is concerned with the future. It helps the management in planning and forecasting.

SCOPE OF MANAGEMENT ACCOUNTING

The following facts of management accounting are of a great significance and form the scope of this subject.

1. Financial Accounting. Financial accounting deals with the historical data. The recorded facts about an organization are useful for planning the future course of action.
2. Cost Accounting. Cost accounting provides various techniques for determining cost of manufacturing products or cost of providing service. It uses financial data for finding out cost of various jobs, products or processes.
3. Financial Management: Financial management is concerned with the planning and controlling of the financial resources of the firm. It deals with raising of funds and their effective utilization.
4. Budgeting and Forecasting. Budgeting means expressing the plans, policies and goals of the enterprise for a definite period in future.
5. Inventory Control. Inventory is used to denote stock of raw materials, goods in the process of manufacture and finished products.
6. Reporting to Management One of the functions of management accountant is to keep the management informed of various activities of the concern so as to assist it in controlling the enterprise. The reports are presented in the form of graphs, diagrams, index numbers or other statistical techniques so as to make them easily understandable. The management accountant sends interim reports to the management and these reports may be monthly, quarterly, half-yearly.
7. Interpretation of Data. The management accountant interprets various financial statements to the management. These statements give an idea about the financial and earning position of the concern. These statements may be.
8. Studied and comparison to statements of earlier periods or in comparison with the statements other similar other concerns.

9. Control procedures and Methods. Control procedures and methods are needed to use various factors of production in a most economical way.
10. Internal Audit. Internal audit system is necessary to judge the performance of every department. The actual performance of every department and individual is compared with the pre-determined standards.
11. Tax Accounting. In the present complex tax systems, tax planning is an important part of management accounting. Income statements are prepared and tax liabilities are calculated. The management is informed about the tax burden from central government state government and local authorities.
12. Office Services. Management accountant may be required to control an office. He will be expected to deal with data processing, filing, copying, duplicating, communicating, etc. He will also be reporting about the utility of different office machines.

MERITS OF MANAGEMENT ACCOUNTING

There are many objectives but the prime objective is to assist the management team of an organization in improving the quality of their decisions. The purpose of management accounting is to help the managerial team with financial information so that they can execute business operations and activities more efficiently. Following is the list of all benefits of management accounting –

1. Decision Making
2. Planning
3. Controlling business operations
4. Organizing
5. Understanding financial data
6. Identifying business problem areas
7. Strategic Management

Decision Making

This is the most important benefit of the process of management accounting. In fact, it is the main purpose of it. In this form of accounting, we use techniques from all fields like costing, economics, statistics, etc.It provides us with charts, tables, forecasts and various such analysis that makes the process of decision making easier and more justified.

Planning

Managerial accounting does not have any strict timelines like financial accounting. It is, in fact, a continuous and ongoing process. So financial and other information is presented to the management at regular intervals like weekly, monthly or sometimes even daily. Hence managers can use this analysis and data to plan the activities of the organization. For example, if the recent data shows a dip in the sales for a certain region, then the sales manager can advise his team and plan some action to rectify the situation.

Identifying Business Problem Areas

If some product is not performing well, or some department is running into unexpected losses, etc. managerial accounting can help us identify the underlying cause. Actually, if the management is diligent and their data and reports are frequent, they can identify the problem very early on. This will allow the management to get ahead of the problem.

Strategic Management

Concept of management accounting is not mandatory by any law. So it can have its own structure according to the company's requirements. So if the company feels certain areas need more in-depth analysis or investigation it can do so freely. This allows them to focus on some core areas. The information presented to them allows them to make strategic management decisions. Like if the company wishes to launch a new product line, or discontinue an existing one, management accounting will play a huge part in this strategy.

LIMITATIONS OF MANAGEMENT ACCOUNTING

1. Based on Accounting Information: Management accounting is based on data supplied by financial and cost accounting. Historical data is used to make future decisions.
2. Lack of Knowledge: The use of management accounting requires the knowledge of a number of related subjects. Management should be conversant with accounting principles, statistics, economics, principles of management etc., and only then management accounting can be effectively utilized.
3. Intuitive Decisions: Intuitive decisions limit the usefulness of management accounting.
4. Not an Alternative to Administration: Management accounting does not provide an alternative to administration
5. Top Heavy Structure: The installation of a management accounting system needs an elaborate organizational system. Smaller units cannot afford to use this system because of heavy cost.
6. Evolutionary Stage: Management accounting is only in a developmental stage, it has not yet reached a final stage. The techniques and tools used by this system give varying and differing results.
7. Personal Bias: Personal prejudices and bias affect the objectivity of decisions.

8. Psychological Resistance: The installation of management accounting involves basic change in organizational set up. New rules and regulations are also required to be framed which affect a number of personnel.

DIFFERENCES BETWEEN MANAGEMENT ACCOUNTING AND FINANCIAL ACCOUNTING:

BASIS FOR COMPARISON	FINANCIAL ACCOUNTING	MANAGEMENT ACCOUNTING
Meaning	Financial Accounting is an accounting system that focuses on the preparation of a financial statement of an organization to provide financial information to the interested parties.	The accounting system which provides relevant information to the managers to make policies, plans and strategies for running the business effectively is known as Management Accounting.
Orientation	Historical	Future
Users	Both internal and external users	Only internal users
Nature of statements prepared	General-purpose financial statements	Special purpose financial statements
Rules	Rules of GAAP are followed	No fixed rules for the preparation of reports
Reports	Only financial aspects	Both financial and non-financial aspects
Time Span	Financial statements are prepared for a fixed period, i.e. one year.	Management Reports are prepared whenever needed.
Objective	To create periodical reports	To assist internal management in planning and decision-making process by providing detailed information on various matters.

BASIS FOR COMPARISON	FINANCIAL ACCOUNTING	MANAGEMENT ACCOUNTING
Publishing and auditing	Required to be published and audited by statutory auditors	It is not meant to be published or audited. It is for internal use only.

FINANCIAL STATEMENT ANALYSIS

Financial Statement Analysis (FSA) can also be defined as the process of identifying financial strengths and weaknesses of the firm by properly establishing relationship between the items of the balance sheet and the profit and loss account.

Financial Ratios and Financial Statement Analysis emphasizes on the influence of financial analysis in business. The important figures in a financial statement are intertwined by many a relationship. It helps the analyst in comprehending these relationships and how each one plays its vital role in understanding a business's growth, performance, scalability and other zones of it.

METHODS OF FINANCIAL STATEMENT ANALYSIS

There are various methods or techniques that are used in analysing financial statements, such as:

1. Comparative Statements
2. Common Size Percentages
3.Trend Analysis
4.Ratios Analysis.

Financial statements are prepared to meet external reporting obligations and also for decision making purposes. They play a dominant role in setting the framework of managerial decisions.

Analysts work in a variety of positions. Some are equity analysts whose main objective is to evaluate potential equity (share) investments to determine whether a prospective investment is attractive and what an appropriate purchase price might be. Others are credit analysts who evaluate the creditworthiness of a company to decide whether (and with what terms) a loan should be made or what credit rating should be assigned. Analysts may also be involved in a variety of other tasks, such as evaluating the performance of a subsidiary company, evaluating a private equity investment, or finding stocks that are overvalued for purposes of taking a short position.

Meaning of Ratio Analysis?

Ratio analysis is a quantitative method of gaining insight into a company's liquidity, operational efficiency, and profitability by studying its financial statements such as the balance sheet and income statement. Ratio analysis is a cornerstone of fundamental equity analysis.

Types of Ratio Analysis

The various kinds of financial ratios available may be broadly grouped into the following six silos, based on the sets of data they provide:

1. Liquidity Ratios

Liquidity ratios measure a company's ability to pay off its short-term debts as they become due, using the company's current or quick assets. Liquidity ratios include the current ratio, quick ratio, and working capital ratio.

2. Solvency Ratios

Also called financial leverage ratios, **solvency ratios** compare a company's debt levels with its assets, equity, and earnings, to evaluate the likelihood of a company staying afloat over the long haul, by paying off its long-term debt as well as the interest on its debt. Examples of solvency ratios include: debt-equity ratios, debt-assets ratios, and interest coverage ratios.

3. Profitability Ratios

These ratios convey how well a company can generate profits from its operations. Profit margin, return on assets, return on equity, return on capital employed, and gross margin ratios are all examples of **profitability ratios**.

4. Efficiency Ratios

Also called activity ratios, **efficiency ratios** evaluate how efficiently a company uses its assets and liabilities to generate sales and maximize profits. Key efficiency ratios include: turnover ratio, inventory turnover, and days' sales in inventory.

5. Coverage Ratios

Coverage ratios measure a company's ability to make the interest payments and other obligations associated with its debts. Examples include the times interest earned ratio and the debt-service coverage ratio.

6. Market Prospect Ratios

These are the most commonly used ratios in fundamental analysis. They include dividend yield, P/E ratio, earnings per share (EPS), and dividend payout ratio. Investors use these metrics to predict earnings and future performance.

UNIT - II

FUNDS FLOW STATEMENT

The Funds Flow Statement is a statement which shows the movement of funds and is a report of the financial operations of the business undertaking. It indicates various means by which funds were obtained during a particular period and the ways in which these funds were employed In simple words,.1 it is a statement of sources and applications of funds.

MEANING AND DEFINITION OF FUNDS FLOW STATEMENT

Funds Flow Statement is a method by which we study changes in the financial position of a business enterprise between beginning and ending financial statements dates. It is a statement showing sources and uses of funds for a period of time.

Foulke defines this statements as:

A statement of sources and application of funds is a technical device designed to analyses the changes in the financial condition of a business enterprise between two dates.

In the words of Anthony - The funds flow statement describes the sources from which additional funds were derived and the use to which these sources were put.

Funds flow statement is called by various names such as Sources and Application of Funds Statement of Changes in Financial Position.

PROCEDURE FOR PREPARING A FUNDS FLOW STATEMENT

The preparation of a funds flow statement consists of two parts:

a. Statement or Schedule of Charges in Working Capital.
b. Statement of Sources and Application of Funds.

a.Statement or Schedule of Changes in Working Capital:

Working Capital means the excess of current assets over current liabilities. Statement of changes in working capital is prepared to show the changes in the working capital between the two balance sheet dates. This statement is prepared with the help of current assets and current liabilities derived from the two balance sheets.

As, Working Capital = Current Assets - Current Liabilities.
So,

I. An increase in current assets increases working capital.
II. A decrease in current assets decreases, working capital.
III. An increase in current liabilities decreases working capital
IV. A decrease in current liabilities increases working capital.

Statement of Schedule of Changes in Working Capital

Effect on Working Capital

Particulars	Previous Year	Current Year	Increase	Decrease
Current Assets:				
Cash in hand				
Cash at bank				

Bills Receivable
Sundry Debtors
Temporary Investments
Stocks/Inventories
Prepaid Expenses
Accrued Incomes
Total Current Assets
Current Liabilities:
Bills Payable
Sundry Creditors
Outstanding Expenses
Bank Overdraft
Short-term advances
Dividends Payable
Proposed dividends*
Provision for taxation*
Total Current Liabilities
Working Capital (CA-CL)
Net Increase or Decreasein Working Capital

Illustration:

Prepare a Statement of changes in Working Capital from the following Balance Sheets of SSM and Company Limited.

Balance Sheets as at December 31

Liabilities	**2015 Rs.**	**2016 Rs.**	**Assets**	**2015 Rs.**	**2016 Rs.**
Equity Capital	5,00,000	5,00,000	Fixed Assets	6,00,000	7,00,000
Debentures	3,70,000	4,50,000	Long-termInvestment	2,00,000	1,00,000

Tax Payable	77,000	43,000	Work-in-Progress	80,000	90,000
Accounts Payable	96,000	1,92,000	Stock-in-trade	1,50,000	2,25,000
Interest Payable	37,000	45,000	Accounts Receivable	70,000	1,40,000
Dividend Payable	50,000	35,000			
Cash	30,000	10,000			
	1130000	**1265000**		**1130000**	**1265000**

Solution:

STATEMENT OF CHANGES IN WORKING CAPITAL

Effect on Working Capital

Particulars	**2006 Rs.**	**2007 Rs.**	**Increase**	**Decrease**
Current Assets:				
Cash 20,000	30,000	10,000	---	
Accounts Receivable	70,000	1,40,000	70,000	---
Stock-in-trade	1,50,000	2,25,000	75,000	---
Work-in-progress	80,000	90,000	10,000	---
	3,30,000	**4,65,000**	---	---
Current Liabilities:				
Tax Payable	77,000	43,000	34,000	--
Accounts Payable	96,000	1,92,000	---	96,000
Interest Payable	37,000	45,000	---	8,000
Dividend Payable	50,000	35,000	15,000	---
	2,60,000	3,15,0000	---	---
Working Capital	70,000	1,50,000	---	---
(CA-CL) Net				
Increase in	80,000	---	---	80,000
Working Capital				

	1,50,000	**1,50,000**	**2,04,000**	**2,04,000**

Illustration:
From the following balance sheets of Bharat Company prepare a statement show in changes in Working Capital.

	31/12/16 Assets	31/12/15 Assets
Goodwill	5000	10000
Cash	70000	25000
Debtors	90000	98000
Closing Stock	120000	87000
Long-term Investments	10000	15000
Land	27000	15000
Preliminary Expenses	3000	5000
	325000	255000
Liabilities		
Trade Creditors	45000	50000
Bills Payable	35000	20000
Loans (Payable during 2017)	20000	---
Share Capital	150000	125000
Profit & Loss Account	75000	60000
	325000	**255000**

Statement showing changes in working capital

Particulars	2015 Rs.	2016 Rs.	IncreaseRs.	Decrease Rs.
Current Assets:				
Cash	25000	70000	45000	

Debtors	98000	90000	8000	
Closing stock	87000	120000	33000	
	210000	280000		
Current Liabilities:				
Trade creditors	50000	45000	5000	
Bills payable	20000	35000	15000	
Loans (Payable during 2017)	---	20000	20000	
	70000	100000		
Working Capital (CA-CL)	140000	180000		
Net increase in Working Capital	40000	40000		
	180000	**180000**	**83000**	**83000**

Statement of Sources and Application of Funds:

Funds flow statement is a statement which indicates various sources from which funds (Working capital) have been obtained during a certain period and the uses or applications to which these funds have been put during that period.

Generally, this statement is prepared in two formats:

a. Report Form
b. T Form or An Account Form or Self Balancing Type.

Specimen of Report From of Funds Flow Statement

Sources of Funds: Rs.

Funds from Operations

Issue of Share Capital

Raising of long-term loans

Receipts from partly paid shares, called up

Sales of non-current (fixed) assets

Non-trading receipts, such as dividends received

Sale of Investments (long-term)

Decrease in Working Capital (as per schedule of

changes in Working Capital)

Total

Applications or Uses of Funds:

Funds Lost in Operations

Redemption of Preference Share Capital

Redemption of Debentures

Repayment of long-term loans

Purchase of non-current (fixed) assets

Purchase of long-term Investments

Non-trading payments

Payments of dividends*

Payment of tax*

Increase in Working Capital (as per schedule of changes

in working capital)

Total

T Form or An Account Form or Self Balancing Type Funds Flow Statement (For the year ended.)

Sources	Rs.	Applications	Rs.
Funds from Operations		Funds lost in Operations	
Issue of Share Capital		Redemption of Preference Share Capital	
Issue of Debentures		Redemption of Debentures	
Raising of long-term loans		Repayment of long-term loans	
Receipts from partly paid shares, called up		Purchase of non-current (fixed) assets	
Sale of non-current (fixed) assets		Purchase of long-term investments	
Non-trading receipts such as dividends		Non-trading payments	
Sale of long-term Investments		Payment of Dividends*	
Net Decrease in Working Capital		Payment of tax*	
Net Increase in Working Capital			

* Note. Payment of dividend and tax will appear as an application of funds only when the items are appropriations of profits and not current liabilities.

SOURCES OF FUNDS

The following are the sources from which funds generally flow (come), into the business :

Funds From Operations or Trading Profits:

Trading profits or the profits from operations of the business are the most important and major source of funds. Sales are the main source of inflow of hinds into the business as they increase current assets (cash, debtors or bills receivable) but at the same time funds flow out of business for expenses and cost of goods sold.

Funds from operations can also be calculated by preparing Adjusted Profit and Loss Account as follows:

Adjusted Profit and Loss Account

	Rs.		Rs.
To Depreciation & Depletion or amortization of fictitious and intangible assets, such as: Goodwill, Patents, Trade Marks, Preliminary Expenses etc.		By Opening Balance (of P & L A/c)	
To Appropriation of Retained Earnings, such as : Transfers to General Reserve, Dividend Equalization Fund, Sinking Fund, etc.		By Transfers from excess provisions	
To Loss on sales of any non-current orFixed asset		By Appreciation in the value of fixed asset	
To Dividends (including interim dividend)		By Dividends received	
To Proposed Dividend (if not taken as aCurrent liability)		By Interest on investments	
To Provision for taxation (if not taken as aCurrent liability)		By Profit on sale of fixed or non-currentAssets	
To closing balance (of P & L A/c)		By Funds from Operations (balancing figure in case debit side exceeds creditside)	
To Funds lost in Operations (balancing figure, in case credit side exceeds the debit side)			

Illustration:

SSM Company presents the following information and you are required to calculate funds from operations.Profit And Loss Account

	Rs.		Rs.

To Expenses:		By Gross profit	2,00,000
Operation	1,00,000	By Gain on sale of plant	20,000
Depreciation	40,000		
To Loss on Sale of building	10,000		
To Advertisement Suspense A/c	5,000		
To Discount (allowed to customers)	500		
To Discount on Issue of Shares			
written off	500		
To Goodwill	12,000		
To Net Profit	52,000		
	2,20,000		**2,20,000**

Solution:

Calculation of Funds from Operations

	Rs.	Rs.
Net profit (as given)	52000	
Add: Non-fund or non-operating items which have beendebited to P/L A/c:		
Depreciation	40000	
Loss on sale of building	10000	
Advertisement written off	5000	
Discount on issue of shares	500	
Good will written off	12000	67500
	119500	
Less: Non-fund or Non-operating items which have been		
Credited to P/L A/c: Gain on sale of plant	20000	20000
Funds from operations		**99500**

APPLICATIONS OR USES OF FUNDS

1. Funds lost in operations
2. Redemption of preference share capital
3. Repayment of long-term loans and redemption of debentures
4. Payments of dividends and Tax
5. Any other Non-trading payment.

ILLUSTRATION:

From the following Balance sheets of the company for the ending 31st December 2016 and 31st December 2017, Prepare schedule of changes in working capital and a statement showing sources and application of funds.

Liabilities	**2016**	**2017**	**Assets**	**2016**	**2017**
Share capital	300000	400000	Plant & Machinery	50000	60000
Sundry creditors	100000	70000	Furniture &Fixtures	10000	15000
P&L A/c	15000	30000	Stock in trade	85000	105000
			Debtors	160000	150000
			Cash	110000	170000
	415000	**500000**		**415000**	**500000**

Solution:

Schedule of Changes in Working Capital	2016	2017	Effect on Working Capital	
	Rs.	Rs.	Increase	Decrease
Current Assets				
Cash	110000	170000	60000	---
Debtors	160000	150000	---	10000
Stock-in-Trade	85000	105000	20000	---
	355000	425000	---	---
Current Liabilities				
Sundry Creditors	100000	70000	30000	---
Working capital (C.A. –C.L.)	255000	355000	---	---
Net Increase in working capital	100000	---	---	100000

	355000	**355000**	**110000**	**110000**

Statement of source and application of fundsfor the year end 31.12.2017

Sources	Rs.	Applications	Rs.
Issue of share capital	100000	Purchase of plant & machinery (60000-50000)	10000
Funds from operations	15000	Purchase of furniture &fixtures(15000-10000)	5000
Net increase in working capital	100000		
	115000		15000

Funds from operations:

Balance of P/L A/c 2017	30000
Less:	
Bal. of P/L A/c In the beginning of the year	15000
Funds from Operations	15000

Illustration:

From the following Balance Sheet of Mr. A, Prepare a schedule of changes in work capital and funds flow statement:

Liabilities	**2016**	**2017**	**Assets**	**2016**	**2017**
Capital	63,000	1,00,000	Cash	15,000	20,000
Long-term Borrowings	50,000	60,000	Debtors	30,000	28,000
Trade Creditors	42,000	39,000	Stock-in-trade	55,000	72,000
Bank Overdraft	35,000	25,000	Land Buildings	80,000	1,00,000
Outstanding Expenses	5,000	6,000	Furniture	15,000	10,000
	195000	230000		195000	230000

Solution:

Schedule of Changes in Working Capital

	2016	2017	Effect on Working Capital	
	Rs.	Rs.	Increase	Decrease
Current Assets				

Cash	15,000	20,000	5,000	
Debtors	30,000	28,000	2,000	
Stock-in-Trade	55,000	72,000	17,000	
	1,00,000	1,20,000		
Current Liabilities				
Trade Creditors	42,000	39,000	3,000	
Bank overdraft	35,000	25,000	10,000	
Outstanding Expenses	5,000	6.000	1,000	
	82,000	70,000		
Working capital	18000	50000		
(C.A. –C.L.)				
Net Increase	32000	32000		
in working capital	50000	50000	35000	35000

FUND FLOW STATEMENT

Sources	Rs.	Applications	Rs.
Raising of long-term borrowings	10000	Purchases of land & Building	20000
(60000- 50000)		(100000- 80000)	
Sales of furniture (15000-10000)	5000	Net increase in working capital	32000
Funds from operations	37000		
	52000		52000

Working Notes:

Long term Borrowings A/c

	Rs.		Rs.
To Balance C/d	60000	By Balance b/d	50000
		By Cash (balancing figures)	10000
	60000		60000

Furniture A/c

	Rs.		Rs.
To Balance b/d	15000	By cash-sale (balancing figure)	5000

		By Balance c/d	10000
	15000		15000

Land and Building A/c

	Rs.		Rs.
To Balance b/d	80000		
To cash-purchase (Bal.Fig.)	20000	By Balance c/d	100000
	100000		100000

Capital A/c

	Rs.		Rs.
To balance c/d	100000	By balance b/d	63000
		By profit (Bal.Fig.)	37000
	100000		100000

Illustration:

From the following balance sheets and additional information given, you are required to calculate funds operations for the year ended 2017.

Liabilities	2016 Rs.	2017Rs.	Assets	2016 Rs.	2017 Rs.
Share capital	100000	150000	Land &buildings	100000	95000
General reserve	30000	30000	Plant &Machinery	80000	90000
Profit & loss a/c	20000	22000	Stocks	70000	110000
6% Debentures	80000	80000	Debtors	20000	25000
Creditors	65000	58000	Investments	---	10000
Provision for tax	5000	10000	Cash	10000	10000
			Goodwill	20000	10000
	300000	350000		300000	350000

Additional information:

a. During 2017, dividends of Rs. 15000 were paid.
b. Depreciation written off plant and machinery amounted to Rs. 6000 and no depreciation has been charged on land and buildings.
c. Provision for tax made during the year Rs. 5000.
d. Profit on sale of machinery Rs. 2000.

Solution:

Calculation of funds from operations	Rs.	Rs.
Closing balance of P/L A/c given in the B/S	22000	
Add: Non-fund or non-operating items already debited to P/L A/c:		
Depreciation	6000	
Dividends	15000	
Provision for tax	5000	
Goodwill	10000	36000
Less: Non-fund or non- operating items already credited to P/L A/c:		
Profit on sale of machinery	2000	
Opening balance of P/L A/c (given in B/S)	20000	22000
Funds from operations	36000	

Provision for tax has been treated as a non-current liability.

Goodwill written off during the year is Rs. 20000- Rs. 10000 = Rs. 10000

Alternatively:
ADJUSTED PROFIT AND LOSS ACCOUNT

	Rs.		Rs.
To depreciation	6000	By opening balance	20000
To dividends	15000	By profit on sale of machinery	2000
To provision for tax	5000	By funds from operations (bal.fig.)	36000
To goodwill	10000		
To closing balance	22000		
	58000		58000

Illustration

From the following balance sheets of A & Co Ltd., you are required to show any increase or decrease in working capital and sources and applications thereof:

Liabilities	31.12.16Rs	31.12.17Rs	Assets	31.12.16Rs.	31.12.17Rs.
Equity share capital	240000	360000	Land	166200	339600
Share premium	24000	36000	Machinery	106800	153900
General reserve	18000	27000	Furniture	7200	4500
P&L Account	58500	62400	Stock	66300	78000
8% Debentures	---	78000	Debtors	109500	117300
Provision for taxation	29400	32700	Bank	14400	12000
Creditors	100500	109200			
	470400	705300		470400	705300

Depreciation written off during the year:

On machinery Rs. 38400 On furniture Rs. 1200

Solution:

	2016Rs.	2017Rs.	Increase in W.C.	Decrease in W.C.
Current Assets:				
Stock	66300	78000	11700	
Bank	109500	117300	7800	
Debtors	14400	12000	---	
	190200	207300	2400	
Current Liabilities:				
Creditors	100500	109200	8700	
Provision for taxation	29400	32700	3300	
	129900	141900		
Working Capital	60300	65400		
Net Increase in W.C.	5100	5100		
	65400	65400	19500	19500

STATEMENT OF SOURCES AND APPLICATIONS OF FUNDS

Sources	Rs.	Applications	Rs.

Issue of share capital	120000	Purchase of land & building	173400
Share premium	12000	Purchase of machinery	85500
Issue of debentures	78000	Net increase in W.C.	5100
Sale of furniture	1500		
Funds from operations	52500		
	264000		264000

Working Notes:

Machinery A/c

	Rs.		Rs.
To balance B/d	106800	By depreciation	38400
To purchase during the year			
(Bal. Fig.)	85500	By balance c/d	153900
	192300		192300

Land & Buildings A/c

To balance B/d	166200	By balance c/d	339600
To purchase during the year			
(Bal. Fig.)	173400		
	339600		339600

Furniture A/c

To balance B/d	7200	By depreciation	1200
		By cash-sale (bal. fig.)	1500
		By balance c/d	4500
	7200		7200

Adjusted Profit & Loss A/c

To transfer to Reserves	9000	By balance b/d	58500
To Depreciation on machinery	38400	By funds from operation	52500
To Depreciation on furniture	1200		
To Balance C/d	62400		
	111000		111000

Illustration:

The following are summarized balance sheets of Star Ltd., on 31st Dec. 2016 and 31st Dec. 2017.

LIABILITIES	2016	2017	ASSETS	2016	2017
Share Capital	600000	800000	Plant & Machinery (at cost)	400000	645000
Debentures	200000	300000	Land & Building (at cost)	300000	400000
P&L A/c	125000	250000	Stock	300000	350000
Creditors	115000	90,000	Bank	20000	40000
Provision for	6000	3,000	Preliminary Expenses	7000	6000
bad &doubtful debts			Debtors	69000	61000
Provision for Depreciation					
-On Land & Building	20000	24,000			
On Plant & Machinery	30000	35,000			
	1096000	**1502000**		**1096000**	**1502000**

Additional Information:

1. During the year a part of machinery costing Rs. 70,000 (accumulated depreciation thereon Rs. 2,000) was sold for Rs. 6,000.
2. Dividends of Rs. 50,000 were paid during the year. You are required to as certain :
    a. Changes in Working Capital for 2007
    b. Funds Flow Statement

Solution:

Statement of Changes in Working Capital

	2016 Rs.	2017Rs.	Increase in W.C.	Decrease in W.C.
Current Assets:				
Stock	300000	350000	50000	
Bank	20000	40000	20000	
Debtors	69000	61000		8000
	389000	451000		
Current Liabilities:				
Creditors	115000	90000	25000	
Provision for bad	6000	3000	3000	

and doubtful debts				
	121000	93000		
Working Capital	268000	358000		
Net Increase in W.C.	90000	----		90000
	358000	**358000**	**98000**	**98000**

Funds Flow Statement

Sources	Rs.	Applications	Rs.
Issue of share capital	200000	Purchase of plant & machinery	315000
Issue of debentures	100000	Purchase of land & building	100000
Sale of machinery	6000	Dividends Paid	50000
Funds from operations	249000	Net increase in Working Capital	90000
	555000		**555000**

Provision for Depreciation on Plant & Machinery A/c

	Rs.		Rs.
To Plant & Machinery A/c (Dep. On machinery sold)	2000	By Balance b/d	30000
To Balance c/d	35000	By Adjusted P/L A/c (Dep. Provided) (bal. fig.)	7000
	37000		37000

Provision for Depreciation on Land & Building A/c

To Balance c/d	24000	By Balance b/d	20000
		By Adjusted P/L A/c(bal. fig.)	4000
	24000		24000

Plant & Machinery A/c

To Balance b/d	4,00,000	By Cash (sale)	6,000
ToCash-Purchases(bal.fig)	3,15,000	By-Provision for Dep.	2,000

		By Adjusted P/L A/c (Loss onsale)	62,000
		By Balance c/d	6,45,000
	7,15,000		**7,15,000**

Adjusted Profit and Loss Account

To provision for depreciation:		By balance c/d	125000
Plant & machinery	7000	By Funds from operations	249000
Land and building	4000		
To Preliminary Expenses written off	1000		
To Dividend	50000		
To Loss on sale of machinery	62000		
To Balance c/d	250000		
	374000		**374000**

CASH FLOW STATEMENT

INTRODUCTION

Cash plays a very important role in the entire economic life of a business. Recognizing the importance of cash flow statement, the Institute of Chartered Accountants of India (ICAT) issued. AS-3 Revised : Cash flow Statements in March, 1997.

Meaning:

Cash Flow Statement is a statement which describes the inflows (sources) and outflows (uses) of cash and cash equivalents in an enterprise during a specified period of time. A cash flow statement summarizes the causes of changes in cash position of a business enterprise between dates of two balance sheets. According to AS-3 (Revised), an enterprise should prepare a cash flow Statement and should present it for each period for which financial statements are prepared.

The terms cash, cash equivalents and cash flows are used in this statement with the following meanings:

FORMAT OF CASH FLOW STATEMENT

A S - 3 (Revised) has not provided any specific format for preparing a cash flow statement.

A widely used format of cash flow statement (Direct Method) is given below:

Cash Flow Statement

(for the year ended ...) Rs. Rs.

Cash Flows From Operating Activities Either

Cash receipts from customers

Cash paid to suppliers and employees

Cash generated from operations

Income-tax paid

Cash flow before extraordinary items

Extraordinary items

Net cash from (used in) Operating activities

Or

Net profit before tax and extraordinary items

Adjustments for non-cash and non-operating items

(List of individual items such as depreciation, foreign exchange

loss, loss on sale of fixed assets, interest income, dividend income, interest expense etc.)

Operating profit before working capital changes

Adjustments for changes in current assets and current liabilities

(List of individual items)

Cash generated from (used in) operations before tax

Income tax paid

Cash flow before extraordinary items

Extraordinary items (such as refund of tax)

Net cash from (used in) operating activities

Cash Flows From Investing Activities

Individual Items of cash inflows and outflows from financing

Activities

(such as) purchase/sale of fixed assets, purchase or sale of

investments, interest received, dividend received etc.

Net Cash from (used in) investing activities

Cash Flows From Financing Activities

Individual items of cash inflows and outflows from financing

Activities

(such as) proceeds from issue of shares, long-term borrowings,

repayments of long-term borrowings, interest paid, dividend paid etc.

Net cash from (used in) financing activities

Net Increase (Decrease) in cash and cash equivalents

Cash and cash equivalents at the beginning of the period

Cash and cash equivalents at the end of the period

PROCEDURE FOR PREPARING A CASH FLOW STATEMENT:

Cash flow statement is not a substitute of income statement, i.e., a profit arid loss account, and a balance sheet. It provides additional information and explains the reasons for changes in cash and cash equivalents, derived from financial statements at two points of time.

The preparation of a cash flow statement involves the following steps:

Step 1:

Compute the net increase or decrease in cash and cash equivalents by makings comparison of these accounts given in the comparative balance sheets.

Step 2:

Calculate the net cash flow provided (used in) operating activities by analysing the profit and loss account, balance sheet and additional information. There are two methods of converting net income into net cash flows from operating activities: the direct method and the indirect method.

These methods have been discussed separately in this chapter.

Step 3 Calculate the net cash flow from investing activities.

Step 4 Calculate the net cash flow from financing activities.

Step 5 Prepare a formal cash flow statement highlighting the net cash flow from (used in) operating, investing and financing activities separately.

Step 6 Make an aggregate of net cash flows from the three activities and ensure that the total net cash flow is equal to the net increase or decrease in cash and cash equivalents as calculated in Step 1.

Step 7 Report significant non-cash transactions that did not involve cash or cash equivalents in a separate schedule to the cash flow statement e.g., purchase of machinery against issue of share capital or redemption of debentures in exchange for share capital.

METHODS OF CALCULATING CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES:

There are two methods of reporting cash flows from operating activities: the direct method and the indirect method.

1. The Direct Method

Under the direct method, cash receipts (inflows) from operating revenues and cash payments (outflows) for operating expenses are calculated to arrive at cash flows from operating activities. The difference between the cash receipts and cash payments is the net cash flow provided by (or used in) operating activities. The following are the examples of cash receipts and cash payments (called cash flows) resulting from activities:

a. Cash receipts from the sale of goods and the rendering of services;
b. Cash receipts from royalties, fees, commissions and other revenues;
c. Cash payment to suppliers for goods and services;
d. Cash payment to and on behalf of employees;
e. Cash receipts and cash payment of an insurance enterprise for premiums and claims, annuities and other policy benefits;
f. Cash payments or refund of income taxes unless they can be specifically identified with financing and investing activities;
g. Cash receipts and payments relating to future contracts, forward contracts, option contracts and swap contracts when the contracts are held for dealing or trading purposes.

The information about major classes of gross cash receipts and gross cash payments may be obtained either:

1. From accounting records of the enterprise;
2. 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 profit and loss 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.

The following calculation is given to illustrate the point with imaginary figures:

	Rs.
(i) Credit Sales given	670000
Add: Opening Balance of Trade Debtors (Debtors + B/R)	80000
	750000
Less: Closing Balance of Trade Debtors	110000
Cash received from debtors/customers	640000
(ii) Cost of Goods Sold (given)	450000
Add: Closing Stock	30000

	480000
Less: Opening Stock	20000
Purchases on accrual basis	460000
(iii) Credit Purchases	460000
Add: Opening Balance of Trade Creditors (Creditors + B/P)	60000
	520000
Less: Closing Balance of Trade Creditors	90000
Cash paid to creditors/suppliers	430000
(iv) Salary as charged to Profit and Loss A/c	75000
Add: Opening Balance of Outstanding Salary	10000
	85000
Less: Closing Balance of Outstanding Salary	5000
Cash paid to employees on account of salaries	80000

Illustration:
From the following information, calculate cash flows from operating activities.

	Rs.
Total sales for the year	250000
Total purchases for the year	200000
Trade debtors as on 1.7.2007	12000
Trade creditors as on 1.7.2007	14500
Trade debtors as on 30.6.2008	20800
Trade creditors as on 30.6.2008	21600
Total operating expenses for the year	10200
Outstanding expenses as on 1.7.2007	1800
Prepaid expenses as on 1.7.2007	1500
Outstanding expenses as on 30.6.2008	2400
Prepaid expenses as on 30.6.2008	2200
Income tax paid during the year	2000

Solution:

Cash flows from operating activities

Cash receipts from customers (working Note: 1)	241200
Cash paid to supplies and employees (working note: 2)	203200
Cash generated from operations	38000
Income tax paid	2000
Net cash flows from operating activities	36000

Working notes:

Calculate of cash receipts from customers:

1.Calculation of cash receipts from customers :	Rs.
Sales for the year	2,50,000
Add : Trade debtors as on 1.7.2007 12.000	2,62,000

Less : Trade debtors as on 30.6.2008 20.800Cash receipts from customers 2.41.200

2.Calculation of cash paid to suppliers and employees :

Total purchases for the year	2,00,000
Add : Trade creditors as on 1.7.2007	14.500
	2,14,500
Less : Trade creditors as on 30.6.2008	21.600
Cash paid to creditors for purchase of goods (a)	1.92.900
Total operating expenses for the year	10,200
Add : Outstanding expenses as on 1.7.2007	1.800
	12,000
Less : Outstanding expenses as on 30.6.2008	2.400
	9,600
Add : Prepaid expenses as on 30.6.2008	2.200
	11,800
Less : Prepaid expenses as on 1.7.2007	1.500
Cash paid for services and expenses (b)	10.300
Cash paid to suppliers and employees (a+b) or	(1,92,900 +10,300) 203200

Illustration:

From the following balance sheets and additional information of ABC Ltd., find out cash crating activities.

Liabilities	31.3.2007	31.3.2008.	Assets	31.3.2007	31.3.2008.
Equity Share Capital	60,000	70,000	Goodwill	20,000	16,000
General Reserve	20,000	30,000	Machinery	82,000	1,08,000
10% Debentures	42,000	50,000	10%Investme	6,000	16,000
Profit and Loss A/c	---	14,000	Stock	8,000	34,000
Sundry Creditors	17,000	25,000	Debtors	4,000	15,000
Provision for Depreciation on					
Machinery	18,000	26,000	Cash and Bank	24,000	26,000
Discount on Debentures	1000	---			
Profit and Loss A/c	12.000	---			
	1,57,000	**2,15,000**		**1,57,000**	**2,15,000**

Additional Information :

(a) Debentures were issued on 31st March, 2008.

(b) Investment were made on 31st March, 2008. Solution

Increase in stock Increase in debtors

Net Cash Flow from Operating Activities

CASH FLOW FROM OPERATING ACTIVITIES

	Rs.		Rs.
Increase in the balance of profit and loss account (14,000 + 12,000 loss)			26000
Add : Non-cash and non-operating items which have been Dr. to P/L A/c			
Transfer to general reserve (30,000 - 20,000)	10000		
Provision for depreciation (26,000 - 18,000)	8000		
Goodwill written off (20,000 - 16,000)	4000		
Discount on debentures written off	1000		
Interest on debentures (10% of 42,000)	4200	27200	
Less :			
Non-cash and non-operating items which have been			
Cr. to P/L A/c :	53200		
Interest on investments (10% of 6000)	(600)		
Operating profit before working capital changes	52600		
Add : Decrease in accounts of current assets except cash and increase in current liabilities			

Increase in sundry creditors (25000-17000)	8000	
Less : Increase in accounts of current assets and decrease in current liabilities :	60600	
Increase in stock	26000	
Increase in debtors	11000	(37000)
Net cash flow from operating activities	23600	

Illustration:

CASH FLOWS FROM INVESTING ACTIVITIES

Calculate net cash flows from investing activities from the following information:

	31.3.2016	31.3.2017
Buildings (w.d.v.)	600000	750000

Additional information:

Building costing Rs. 100000 on which Rs. 30000 had accumulated as depreciation was sold Rs. 60000.

Depreciation charged on buildings for the year ended 31.3.2017 Rs. 50000.

Solution:

Building A/c

	Rs.		Rs.
To balance b/d	600000	By cash (sale)	60000
To cash (purchase – bal.fig.)	270000	By P/L a/c (loss)	10000
		By depreciation	50000
		By balance c/d	750000
	870000		**870000**

CALCULATION OF NET CASH FLOWS FROM INVESTING ACTIVITIES

	Rs.	Rs.
Sale of buildings	60000	
Purchase of buildings	(270000)	
Net cash used in investing activities	(210000)	

Illustration:

CASH FLOWS FROM FINANCING ACTIVITIES

From the information given below, calculate cash flows from financing activities.

	2016Rs.	2017Rs.
Equity share capital	200000	300000
8% debentures	100000	50000
Securities premium	20000	30000
Bank loan (long-term)	---	100000

Additional information: Interest paid on debentures Rs. 8000.

Solution:

CALCULATION OF CASH FLOWS FROM FINANCING ACTIVITIES

	Rs.	Rs.
Issue of share capital	100000	

Redemption of debentures	(50000)
Proceeds from securities premium	10000
Raising of Bank Loan	100000
Interest on Debentures paid	(8000)
Net Cash Flows From Financing Activities	152000

Illustration:

From the summary Cash Amount of Sunny Ltd. prepare Cash Flow Statement for the year ended 31st March, 2017 in accordance with AS-3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account (For the year ended 31.3.2017)

Receipts	Rs. '000	Payments	Rs. '000
Balance on 1.4.2007	100	Payment of suppliers	4000
Issue of equity shares	600	Purchase of fixed assets	400
Receipts from customers	5600	Overhead expenses	400
Sale of fixed assets	200	Wage and salaries	200
		Taxation	500
		Dividend	100
		Repayment of bank loan	600
		Balance on 31.3.2008	300
	6500		**6500**

CASH FLOW STATEMENT

(for the year ended 31.3.2017)

	Rs.'000	Rs.'000
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash receipts from customers		5600
Cash paid to suppliers and employees (4000+400+200)		(4600)
Cash generated from operations		1000
Income tax paid		(500)
Cash flow from operating activities		500
CASH FLOW FROM INVESTING ACTIVITIES		
Sale of fixed assets		200
Purchase of fixed assets		(400)
Net cash used in investing activities		(200)
CASH FLOWS FROM FINANCING ACTIVITIES		
Issue of equity shares		600
Dividend paid		(100)
Repayment of bank loan		(600)
Net cash used in financing activities		(100)
Net increase in cash and cash equivalents		200
Cash and cash equivalents at the beginning of the period		100

Cash and cash equivalents at the end of the period	300

Illustration

The following details are available from a company.

	31-12-06 Rs.	31-12-07 Rs.		31-12-06 Rs.	31-12-07 Rs.
Share Capital	70,000	74,000	Cash	9,000	7,800
Debentures	12,000	6,000	Debtors	14,900	17,700
Reserve for doubtful debts	700	800	Stock	49,200	42,700
Trade Creditors	10,360	11,840	Land	20,000	30,000
P/L A/c	10,040	10560	Goodwill	10,000	5,000
	103100	**103200**		**103100**	**103200**

In addition, you are given:

Dividend paid total Rs. 3,500.
Land was purchased for Rs. 10,000.
Amount provided for a mortisation of goodwill Rs. 5,000. Debentures paid off Rs. 6,000.
Prepare Cash Flow Statement,

Solution:

Cash Flow Statementfor ended 31st December, 2007)

CASH FLOWS FROM OPERATING ACTIVITIES	Rs.	Rs.
Increase in the balance of P/L A/C		520
Adjustments for non-cash and non-operating items:		
Reserve for Doubtful Debts		100
Dividend		3500
Goodwill written off		5000
Operating Profit before working capital changes		9120
Adjustments for changes in current operating assets and liabilities:		
Increase in Trade Creditors		1480
Increase in Debtors		(2800)
Decrease in Stock		6500
Cash generated from operations		14300
Income tax paid		---
Net cash from operating activities		14300
Cash Flows from Investing Activities		
Purchase of Land		(10000)
Net cash used in investing activities		(10000)
Cash Flows from Financing Activities		
Proceeds from the issue of Share		4000
Capital Redemption of Debentures		(6000)
Dividend paid		(3500)
Net cash used in financing activities		(5500)
Net Decrease in cash and cash equivalents		(1200)

Cash and cash equivalents at the beginning of the period 9000
Cash and cash equivalents at the end of the period 7800

Illustration: The Balance Sheet of ABC Ltd. is as follows :

Liabilities	1.1.07 (Rs.)	31.12.07 (Rs.)	Assets	1.1.07 (Rs.)	31.12.07 (Rs.)
Equity Capital	100000	100000	Cash	10000	7200
General Reserve	100000	100000	Debtors	70000	76800
Profit and Loss A/c	96000	98000	Stock	50000	44000
Current Liabilities	72000	82000	Land	40000	60000
Loan from Associate Company	---	40000	Buildings	100000	110000
Loan from Bank	62000	50000	Machinery	160000	172000
	430000	**470000**		**430000**	**470000**

Solution:
CASH FLOW STATEMENT
(for the year ended 31.12.2007)

	Rs.	Rs.
CASH FLOWS FROM OPERATING ACTIVITIES		
Increase in the balance of P/L A/c	2000	
Adjustments for non-cash and non-operating items:		
Dividend paid	52000	
Provision for depreciation on machinery (72,000-54,000)	18000	
Operating profit before working capital changes	72000	
Adjustments for changes in current operating assets and liabilities:		
Increase in debtors	(6800)	
Decrease in stock	6000	
Increase in current liabilities	10000	
Cash generated from operations before tax	81200	
Less: Income tax paid	---	
Net Cash from operating activities	81200	
CASH FLOW FROM INVESTING ACTIVITIES		
Purchase of land (60,000-40,000)	(20000)	
Purchase of buildings (1,10,000-1,00,000)	(10000)	
Purchase of machinery (1) (30000)	(60000)	
Net Cash used in investing activities		
CASH FLOWS FROM FINANCING ACTIVITIES		
Loan from associate company	40,000	
Loan repaid to bank	(12,000)	
Dividend paid (52.000)	(24000)	

Net Decrease in cash a cash equivalents	(2800)
Cash and cash equivalents at the beginning of the period	10000
Cash and cash equivalents at the end of the period	7200

Working Notes:

Machinery A/c (At written down values)

	Rs.		Rs.
To Balance b/d	160000	By Depreciation(72,000-54,000)	18000
To Cash-purchased (bal. fig.)	30000	By Balance c/d	172000
	190000		**190000**

Illustration:

The Balance Sheets of M/S A and B on 1.1.2017 and 31.12.2017 were as follows.

LIABILITIES	1.1.2017	31.12.2017	ASSETS	1.1.2017	31.12.2017
Creditors	1,20,000	1,32,000	Cash	30,000	21,000
Mrs A's Loan	75,000		Debtors	90,000	1,50,000
Loan from Bank	1,20,000	1,50,000	Stock	1,05,000	75,000
Capital	3,75,000	4,59,000	Machinery	2,40,000	1,65,000
			Land	1,20,000	1,50,000
			Building	1,05,000	1,80,000
	6,90,000	**7,41,000**		**6,90,000**	**7,41,000**

During the year a machine costing Rs. 30,000 (accumulated depreciation Rs. 9,100 was sold for Rs. 15,000. The provision for depreciation against machinery as on 1.1.2007 was Rs. 75,000 and on 31.12.2007 Rs. 1,20,000. Net profit for the year 2007 amounted to Rs. 1,35,000. Prepare Cash Flow Statement

Solution:

Cash Flow Statement
(for the year ended 31.12.2007)

	Rs.	Rs.
CASH FLOWS FROM OPERATING ACTIVITIES		
Net profit for the year (Working Note 3)	135000	
Adjustments for non-cash and non-operating items:	6000	
Loss on sale of machinery	54000	
Depreciation provided during the year	195000	
Operating profit before working capital changes		
Adjustments for changes in current operating assets and liabilities:		
Increase in debtors	(60000)	
Decrease in stock	30000	
Increase in creditors	12000	
Cash generated from operations	177000	
Less: Income tax paid ---		
Net Cash from operating activities	177000	

CASH FLOWS FROM INVESTING ACTIVITIES

Sale of machinery	15000
Purchase of land	(30000)
Purchase of building	(75000)
Net cash used in investing activities	(90000)

CASH FLOWS FROM FINANCING ACTIVITIES	
Repayment of Mrs. A's Loan	(75000)
Loan from bank	30000
Drawings from capital (see capital account)	(51000)
Net cash used in financing activities	(96000)
Net Decrease in cash and cash equivalents	(9000)
Cash and cash equivalents at the beginning of the period	30000
Cash and cash equivalents at the end of the period	21000

Workings:

Provision for depreciation A/c	Rs.		Rs.
To depreciation on machinery sold	9000	By balance b/d	75000
To balance b/d	120000	By profit and loss A/c (depreciationprovided during the year)	54000
	129000		129000

Machinery A/c (At cost)	Rs.		Rs.
To balance b/d (240000+75000)	315000	By provision for depreciation (Dep. On Machinery sold)	9000
		By cash (sale)	15000
		By loss on sale	6000
		By balance c/d (165000+12000)	285000
	315000		315000

Capital A/c	Rs.		Rs.
To drawings (Bal. fig.)	51000	By balance b/d	375000
To balance c/d	459000	By net profit (given)	135000
	510000		510000

TRADING AND PROFIT AND LOSS ACCOUNT
for the year ending 31st March, 1998

	Dr. Rs.		Cr. Rs.
To Purchases	20,000	By Sales	30,000
To Wages	5,000		
To Gross Profit c/d	5,000		
	30,000		30,000

To Salaries	1,000	By Gross Profit/b/d	5,000
To Rent	1,000	By Profit on sale out building	
To Depreciation onPlant	1,000		
BookValue	10,000		
To Goodwill written Off	1,000		
To Net Profit	5,500		
	10,000		10,000

Calculate the cash from operations.

Solution:

CASH FROM OPERATIONS

	Rs.	Rs.
Net Profit as per P & L Account		5,500
Add: Non-cash items (items which do not result in outflow of cash):		
Depreciation	1,000	
Loss on sale of furniture	500	
Goodwill written off	1,000	2,500
Less: Non-cash items (items which do not result In Inflow of cash):	8,000	
Profit on sale of building (Rs. 15,000 will be taken as a separate source of cash)	5,000	
Cash from operations		3,000

Example:

From the following balances, you are required to calculate cash from operations:

December 31

	1997Rs.	1998Rs.
Debtors	50,000	47,000
Bills Receivable	10,000	12,500
Creditors	20,000	25,000
Bills Payable	8,000	6,000
Outstanding Expenses	1,000	1,200
Prepaid Expenses	800	700
Accrued Income	600	750
Income received in Advance	300	250
Profit made during theyear	-	1,30,000

Solutions:

CASH FROM OPERATIONS

	December 1997Rs.	31st 1998Rs.
Profit made during the year		1,30,000
Add: Decrease in Debtors	3,000	
Increase in Creditors	5,000	

Increase in Outstanding Expenses	200	
Decreases in prepaid expenses	100	8,300
		1,38,300
Less: Increase in Bills Receivable	2,500	
Decrease in Bills payable	2,000	
Increases in Accrued Income	150	
Decrease in Income received in Advance	50	4,700
Cash from Operations		1,33,600

DIFFERENCE BETWEEN FUND FLOW STATEMENT AND CASH FLOW STATEMENT

Cash Flow	Fund Flow
Definition	
Cash flow is based on the concept of outflow and inflow of cash and cash equivalents during a particular period	Fund flow is based on the concept of changes in working capital over a period of time