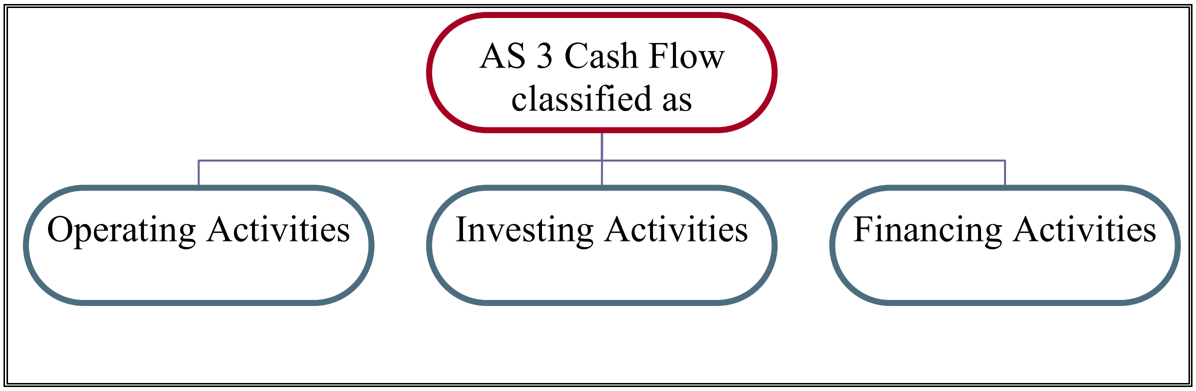
CASH FLOW AND FORECASTING CASH FLOWS

(adapted from AS 3 and AS 28)

Accounting Standard 3 defines how to disclose cash flows of an enterprise. Cash flows denote the true profit generating ability by linking the profits and cash intake and hence are difficult to manipulate.
As per this statement issued by the ICAI cash flows are classified as



Operating Activities :

These are the principle revenue generating activities of the enterprise. It is the main business from cash receipts of customers, advances from them, payments to creditors and payments for expenses such as administrative, selling and distribution and overheads and production expenses, income tax etc.

Investing Activities :

These are the activities that arise from making investments in machinery, production equipment, office Equipment i.e. Fixed Assets, Loans made to third parties and Interest / Income from Investments etc.

Financing Activities :

These are activities that arise from changes in Share capital eg. Issue and redemption of Share capital, Interest paid, Dividend paid etc.

It also tells us that cash flow can be made as per direct method or indirect method like this

Cash Flow Statement (Indirect Method)

A	CASH FLOW FROM OPERATING ACTIVITIES		
	Net Profit Before Tax		-
	Adjustments for:		
	Depreciation	-	
	Preliminary Expenses w/off	-	
	Deferred Revenue Expenditure	-	
	(Profit)/loss on sale of Assets	-	
	Interest & Finance Charges	-	
	Interest on FD	-	
	Dividend Income	-	-
	Operating Profit before Working Capital Changes		-
	Adjustments for:		
	Decrease/(Increase) in Receivables	-	
	Decrease/(Increase) in Inventories	-	
	Increase/(Decrease) in Payables	-	-
	Cash generated from operations		-
	Income Tax paid		-
	Net Cash flow from Operating activities after tax		-
B	CASH FLOW FROM INVESTING ACTIVITIES		
	Purchase of Fixed Assets	-	
	Mutual Fund	-	
	Sale of Fixed Assets	-	
	Increase in Advances & others	-	
	Interest on FD	-	
	Dividend Income	-	
	Net Cash used in Investing activities		-
C	CASH FLOW FROM FINANCING ACTIVITIES		
	Proceeds from Long term Borrowings	-	
	Interest paid	-	
	Net Cash used in financing activities		-
	Net increase in cash & Cash Equivalents		-
	Cash and Cash equivalents as at 01.04.....		-
	Cash and Cash equivalents as at 31.03......		-

Cash & Cash Equivalents	As on	
Cash in Hand		
Cash at Bank		
Cash & Cash equivalents as stated	-	-

Cash Flow Statement (Direct Method)

A	**CASH FLOW FROM OPERATING ACTIVITIES**		
	Cash Receipts		
	a) from sales	-	
	b) from customers	-	-
	Less : **Cash Payments**		
	a) to Creditors	-	
	b) Other Expenses	-	-
	Cash generated from operations		-
	Income Tax paid		-
	Net Cash flow from Operating activities after tax		-
	Add / Less Extra ordinary Items		-
	Net Cash flow from Operating activities		-
B	**CASH FLOW FROM INVESTING ACTIVITIES**		
	Purchase of Fixed Assets	-	
	Mutual Fund	-	
	Sale of Fixed Assets	-	
	Increase in Advances & others	-	
	Interest on Fd	-	
	Dividend Income	-	
	Net Cash used in Investing activities		-
C	**CASH FLOW FROM FINANCING ACTIVITIES**		
	Proceeds from Long term Borrowings	-	
	Interest paid	-	
	Net Cash used in financing activities		-
	Net increase in cash & Cash Equivalents		-
	Cash and Cash equivalents as at 01.04.....		-
	Cash and Cash equivalents as at 31.03......		-

Cash & Cash Equivalents	As on	
Cash in Hand		
Cash at Bank		
Cash & Cash equivalents as stated	-	-

But the important part remains….HOW TO ESTIMATE CASH FLOWS?

Estimations of cash flows can be used for checking impairment of assets (as per AS28) or in a wider sense can be used for making financial projections. AS 28 specifies the estimations of cash flow, assumptions, discount rates from a Cash Generating Unit or a specific asset that is impaired. The logic can be used for a forecasted statement. It states

1) Estimating Cash flow involves two things
    a) Estimate the future cash inflow and outflow from activities and discontinuance of activities.
    b) Estimate the appropriate discount rate (for impairment)or rate of return (for forecasting)

2) Cash flow involves a supportable assumption of the management that's is a best estimate of the economic conditions that will exist over the life of the entity. This involves a study from viewpoint of organization (better known by management) and viewpoint of Economy or Industry (better known by Estimates Committee's , Trade Associations based on industry study reports)

3) Budgets must be made for maximum of Five Years unless a longer period is necessary.

4) Based on accounting principle of prudence a declining growth rate must be used ..unless industry report indicate a rising growth rate. The growth rate must not exceed long term average growth rate for products in which the enterprise operates.

5) Estimations must contain assumptions as to price increase due to general inflation. Therefore the discount rate or rate of return must be adjusted for changes in inflation rates. If they are adjusted then the cash flow denote a nominal cash flow and if rate of return does not consider inflation effect, then make changes for specific price increases in certain years as per management assumptions.

6) Cash flows are always estimated for the current conditions. Future restructuring that is not yet committed and future capital expense that enhance the life of assets and generate revenue should not be included unless a certified valuer's report for the machine is obtained.

7) Cash flows should not include cash inflow from financing activity and income tax payments. Even the discount and rates of return and cash flows themselves are on a pre tax basis. But it would be prudent to estimate the tax liability based on forecasts.

8) Foreign currency cash flows can be stated in the currency in which they will be generated and then discounted using the appropriate rates of return.

Hence from now you can use Forecasted statements based on logic of these standards , supplement then with the appropriate Reports for your assumptions…….and then see the smile on your bankers face …when you go to extract a loan!!!!

Thank you for reading!