Hi, friends!

In continuation to my first part Preparation of Cash Flow Statement; I'm writing this article to make it easier to prepare the cash flow statement. The second part explains the preparation of working notes.

First we are going to start with Net Profit before Taxes which opens up 3 different accounts.

As you know to arrive at Net Profit before Taxes:

Difference between P&L a/c balances of two years in the B/S

Add:

Transfer to reserves

Provision for dividend

Provision for tax

Transfer to Reserves: Any transfer of profit from P & L a/c to reserves will be added directly. But sometimes you will be given the amount of transfer which you have to find using other info.

General Reserve a/c

Particulars	Amount	Particulars	Amount
To Any Transfer (E.g.: Capital Redemption Reserve) To Balance c/d (Closing Balance)		By Balance b/d (Opening Balance) By P & L a/c (Balancing Figure)	

As you notice in the above a/c, P & L a/c is the balancing figure i.e. the amount of profit transferred from P & L a/c to General Reserve.

Proposed Dividend a/c

Particulars	Amount	Particulars	Amount
To Cash or Bank a/c (Dividend Paid during the year) To Balance c/d (Closing Balance, if any)		By Balance b/d (Opening Balance, if any) By P & L a/c (Amount of dividend proposed for the year)	

Now in the above a/c the balancing figure can be Cash or Bank a/c or P & L a/c based on the information given. If amount of dividend paid during the year is given then the balancing figure is P & L a/c or vice-versa. Sometimes neither of them will be given. Then you will assume that the Opening balance as the amount of Dividend paid (Cash or Bank a/c) and Closing balance as the amount of dividend proposed (P & L a/c).

Provision for Taxes a/c

Particulars	Amount	Particulars	Amount
To Cash or Bank a/c (Taxes Paid during the year) …………... (Or) …………. To Advance Tax a/c (If there is advance payment) To Balance c/d (Closing Balance, if any)		By Balance b/d (Opening Balance, if any) By P & L a/c (Amount of provision created for taxes during the year)	

It is same as the Proposed Dividend a/c. The balancing figure can be Cash or Bank a/c or P & L a/c based on the information given. If amount of provision created is given then the balancing figure is P & L a/c or vice-versa. Sometimes neither of them will be given. Then you will assume that the Opening balance as the amount of taxes paid (Cash or Bank a/c) and Closing balance as the amount of provision created for taxes (P & L a/c).

Advance Tax a/c

Particulars	Amount	Particulars	Amount
To Balance b/d (Opening Balance, if any) To Cash or Bank a/c (Advance Taxes Paid during the year)		By Provision for Taxes a/c By Bank a/c (If there is any refund of Tax) By Balance c/d (Closing Balance, if any)	

If there is Provision for Taxes a/c and Advance Taxes a/c then the balancing figure will be find out after adjusting the advance tax against the provision created.

Fixed Assets a/c (At Cost)

Particulars	Amount	Particulars	Amount
To Balance b/d To Cash or Bank a/c (purchase of assets) To Equity Share Capital a/c (Capital issued for the purchase)		By Depreciation a/c By Asset Disposal a/c (Cost of the machinery sold) By Balance c/d	

In the above a/c, the balancing figure can be Depreciation or Cash a/c. The above a/c can be prepared when the cost of asset sold and depreciated accumulated on such asset are given.

Accumulated Depreciation a/c

Particulars	Amount	Particulars	Amount
To Asset Disposal (Total Amount of depreciation on asset sold) To Balance c/d		By Balance b/d By Depreciation a/c (For the year) By Asset Disposal a/c (Cost of the machinery sold)	

Asset Disposal a/c

Particulars	Amount	Particulars	Amount
To Fixed Assets a/c To P & L a/c (Profit on sale of asset)		By Accumulated Depreciation a/c (Total Depreciation provided on the asset sold from purchase to date of sale) By Bank a/c By P & L a/c (Loss on sale of asset)	

If only depreciated values are given then the following a/c will be prepared…..

Fixed Assets a/c

Particulars	Amount	Particulars	Amount
To Balance b/d To Cash or Bank a/c (purchase of assets) To Equity Share Capital a/c (Capital issued for the purchase) To P & L a/c (If there is profit on sale)		By Depreciation a/c By Bank a/c (Amount realized on asset sold) By P & L a/c (If there is loss on sale) By Balance c/d	

While preparing the Cash Flow Statement, you will take only cash purchase of fixed assets and ignore the assets purchased by issuing shares....

Investments (Long Term) a/c

Particulars	Amount	Particulars	Amount
To Balance b/d To Cash or Bank a/c (purchase of investment) To P & L a/c (If there is profit on sale)		By Bank a/c (Amount realized on investment sold) By P & L a/c (If there is loss on sale) By Balance c/d	

Investments a/c is same as the Fixed Assets a/c except it doesn't have depreciation...

Preference Share Capital or Debentures a/c

Particulars	Amount	Particulars	Amount
To Bank or Cash a/c (Redemption of Debentures (or) Preference) To Balance c/d (If any)		By Balance b/d By Bank or Cash a/c (New Issue) By Premium on Redemption of Debentures (or) Preference Share Capital	

Interest Payable (Expenses Payable)

Particulars	Amount	Particulars	Amount
To Bank or Cash a/c (Interest paid during the year) To Balance c/d (If any)		By Balance b/d By P & L a/c (Interest Expenses for the year)	

Remember while solving a question; don't search for the missing information. First prepare all the accounts possible and enter given information in the accounts. Then you will be able to find those required information to prepare the statement easily....

First Part

Cash flow statement….As the name itself indicates the statement which only deals with inflow and outflow of cash (and cash equivalents) during the accounting year. Our work is to classify those inflows and outflows into three activities namely operating, investing and financing activities.

Cash from Operating Activities include cash generated from production and related activities i.e. cash generated in the normal course of business….

Some of inflows and outflows include:

- Receipts from sale of goods
- Operating expenses (Cash related)
- Payments for purchase of goods and services
- Commissions and royalties received etc.

Cash from Investing Activities include cash flows from long term investments and sale or acquisition or generation (Capital work-in-progress) of long term assets....

Some of inflows and outflows include:

- Receipts from sale of long term assets and investments
- Payments for acquisition of long term investments and assets
- Interest and Dividends received
- Loans and advances to third parties etc.

Cash from Financing Activities include cash flows which result from change in the capital and borrowings of the company….

Some of inflows and outflows include:

- Redemption of preference share capital and debentures
- Receipts from issue of equity shares, preference shares, loans, debentures etc.
- Interest and dividend payments etc.

Preparation of cash flow statement (Direct method):

It is the easiest method. The only difference between direct and indirect method is procedure of arriving at cash from Operating Activities. In direct method you will directly consider cash related items and exclude any non-cash items while arriving at cash from Operating Activities. Simply you are preparing cash P&L a/c. anyhow while preparing cash flows from Investing and Financing you will add any receipts and deduct any payments directly.

Preparation of cash flow statement (Indirect method):

While starting with operating activities, you will consider Net profit before taxes

How to arrive at net profit before taxes:

Operating Activities:

Difference between P&L a/c balances of two years in the B/S

Add:

- Transfer to reserves
- Provision for dividend
- Provision for tax

Then you will arrive at net profit before taxes. After arriving at this figure…..

Add:

- Any miscellaneous expenditure written off during the year (preliminary expenses, premium on redemption etc.)
- Loss on sale of fixed assets/ long term investments (since non – operating expenses)
- Depreciation provided during the year (since non – cash item)
- Any foreign exchange loss (since non – cash item)
- Dividend or Interest paid (since non – operating expenses) etc.

Less:

- Profit on sale of fixed assets/ long term investments
- Any foreign exchange gain
- Dividend or interest received etc.

Now you will arrive at operating profit before working capital changes, extraordinary items and taxes……Then Adjustments for working capital changes:

Add:

- Decrease in current assets
- Increase in current liabilities

Less:

- Increase in current assets
- Decrease in current liabilities

Now you will arrive at ***"Cash generated from Operations".***

Less: Any taxes paid during the year

You will arrive at ***"Cash from Operating Activities before Extraordinary Items"***

Add: Refund of Taxes, Insurance claim received etc.

Less: Voluntary Separation Scheme etc. (should be shown at the end because of its nature)

Now you will arrive at **"Net Cash from Operating Activities".** (A)

Investing Activities:

Add:

Receipts from sale of Long term Assets/Investments

Interest/Dividend received

Less:

Purchase of Long term Assets/Investments

Expenditure on Capital Work in Progress

Loans given to any third parties

Now you will arrive at **"Net Cash from Investing Activities".** (B)

Financing Activities:

Add:

Share Capital/loans/debentures issued

Less:

Interest/Dividend paid

Redemption of Preference/Debentures/Loans

Now you will arrive at **"Net Cash from Financing Activities".** (C)

Net Cash received/paid during the year (A) + (B) +(C)

Opening balance of cash and cash equivalents

Closing Balance of Cash and Cash equivalents

NOTE 1:

You will add Provision for dividend and Provision for tax only when they are Non-Current Liabilities. If you assume them as current liabilities then you should show these under Working Capital Changes….

NOTE 2:

Verify whether such expenses had been written off against the securities premium available. If the Securities Premium a/c balance has decreased compared to previous year then you should not add these expenses….

NOTE 3:

Any extraordinary items should be shown under appropriate activity separately. These items include:

- Insurance claim received
- Refund of tax
- Winnings from law suit etc.

NOTE 4:

If there is any foreign exchange gain or loss a reconciliation statement to be prepared reconciling the Cash and Cash equivalents balances, as there is no inflow or outflow of cash….

THANKS AND BEST REGARDS

RAGHURAM