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As-3 Cash Flow Statement

Introduction

- This Standard is mandatory for the enterprises, which fall in the *category of level I,* at the end of the relevant accounting period.
- For all other enterprises though it is not compulsory but it is *encouraged to prepare such statements.*

Objective

Cash flow Statement (CFS) is an additional information provided to the users of accounts in the form of an statement, which reflects the various sources from where *cash was generated (inflow of cash)* by an enterprise during the relevant accounting year and how these *inflows were utilised (outflow of cash)* by the enterprise. This helps the users of accounts :

- To identify the *historical changes* in the flow of cash & cash equivalents.
- To determine the *future requirement* of cash & cash equivalents.
- To assess the ability to *generate cash & cash equivalents.*
- To *estimate* the further requirement of generating cash & cash equivalents.
- To compare the *operational efficiency* of different enterprises.
- To study the *insolvency and liquidity position* of an enterprise.
- As an indicator of *amount, timing and certainty* of future cash flows.
- To check the *accuracy of past assessments* of future cash flows.
- In examining the *relationship between profitability and net cash flow* and the impact of changing prices.

Meaning of the term cash and cash equivalents for cash flow statements

Cash and cash equivalents for the purpose of cash flow statement consists of the following:

- *Cash in hand and deposits repayable on demand* with any bank or other financial institutions and

- Cash equivalents, which are *short term, highly liquid investments that are readily convertible into known amounts of cash and are subject to insignificant risk or change in value.*

Note : For the purpose of cash flow statement, 'cash and cash equivalent' consists of at *least three balance sheet items, viz. cash in hand; demand deposits with banks etc.* and investments regarded as cash equivalents. For this reason, the AS 3 requires enterprises to give a break-up of opening and closing cash shown in their cash flow statements. This is presented as a note to cash flow statement.

Meaning of the term cash flow

Cash flows are inflows (i.e. receipts) and outflows (i.e. payments) of cash and cash equivalents. *Any transaction, which does not result in cash flow, should not be reported* in the cash flow statement. Movements within cash or cash equivalents are not cash flows because they do not change cash as defined by AS 3, which is sum of cash, bank and cash equivalents. For example, acquisitions of cash equivalent investments or cash deposited into bank are not cash flows.

Types of Cash Flows

- The **operating cash flows** are cash flows generated by operating activities or by other activities that are not investing or financing activities. Operating activities are the *principal revenue-producing activities of the enterprise.* Examples include, cash purchase and sale of goods, collections from customers for goods, payment to suppliers of goods, payment of salaries, wages etc.

- The ***investing cash flows*** are cash flows generated by investing activities. The investing activities are the *acquisition and disposal of long-term assets and other investments not included in cash equivalents.* The examples of investing cash flows include cash flow arising from investing activities include: (a) receipts from disposals of fixed assets; (b) loan given to / recovered from other entities (other than loans by financial enterprises) (c) payments to acquire fixed assets (d) Interests and dividends earned (other than interests and dividends earned by financial institutions).

- The ***financing cash flows*** are cash flows generated by financing activities. Financing activities are activities that result in changes in the *size and composition of the owners' capital (including preferences share capital in the case of company) and borrowings of the enterprise.* Examples include issue of shares / debentures, redemption of debentures / preference shares, payment of dividends and payment of interests (other than interests paid by financial institutions).

Exchange gains and losses

The change in cash or cash equivalents due to exchange gains and losses are however not cash flows. This being so, the net increases/decreases in cash or cash equivalents in the cash flow statements are stated exclusive of exchange gains and losses. *The resultant difference between cash and cash equivalents as per the cash flow statement and that recognised in the balance sheet is reconciled in the note on cash flow statement.*

Disclosures

AS 3 requires an enterprise to disclose the amount of significant cash and cash equivalent balances held by it but not available for its use, together with a commentary by management. This may happen for example, in case of bank balances held in other countries subject to such exchange control or other regulations that the fund is practically of no use.

AS 3 encourages disclosure of additional information, relevant for understanding the financial position and liquidity of the enterprise together with a commentary by management. Such information may include:

a. The amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities; and
b. The aggregate amount of cash flows required for maintaining operating capacity, e.g. purchase of machinery to replace the old, separately from cash flows that represent increase in operating capacity, e.g. additional machinery purchased to increase production.

Example

X Ltd. purchased debentures of ` 10 lacs of Y Ltd., which are redeemable within three months. How will you show this item as per AS 3 while preparing cash flow statement for the year ended on 31st March, 2017?

Answer

As per AS 3 on 'Cash flow Statement', cash and cash equivalents consists of cash in hand, balance with banks and short-term, highly liquid investments. If investment, of ` 10 lacs, made in debentures is for short-term period then it is an item of 'cash equivalents'. However, if investment of ` 10 lacs made in debentures is for long-term period then as per AS 3, it should be shown as cash flow from investing activities.

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