

Accounting Standard 3 – “Cash Flow Statements”

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Introduction

- ❑ An enterprise should prepare a cash flow statement and should present it for each period for which financial statements are presented.
- ❑ A statement of cash flows, when used in conjunction with the rest of the financial statements, provides information that enables users to evaluate the changes in net assets of an entity, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities
- ❑ Historical cash flow information is often used as an indicator of the amount, timing and certainty of future cash flows.
- ❑ It is also useful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and the impact of changing prices.
- ❑ It is not applicable for Small Companies as defined in Section 2(85) of the Companies Act, 2013.

Definition

- ❑ **Cash** - comprises cash on hand and demand deposits.
- ❑ **Cash equivalents** - are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value
- ❑ **Cash flows** - are inflows and outflows of cash and cash equivalents
- ❑ **Operating activities** - are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities
- ❑ **Investing activities** - are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.
- ❑ **Financing activities** - are activities that result in changes in the size and composition of the owner's capital (including preference share in case of company) and borrowings of the enterprise.

Presentation of Cash Flows

- The statement of cash flows shall report cash flows during the period classified by operating, investing and financing activities.
- Classification by activity provides information that allows users to assess the impact of those activities on the financial position.
- A single transaction may include cash flows that are classified differently.
- Information about activities may also be used to evaluate the relationships among those activities.

Operating Activities

- ❑ Cash flows from operating activities are primarily derived from the principal revenue producing activities of the entity.
- ❑ Examples of cash flows from operating activities are:
 - cash receipts from the sale of goods and the rendering of services;
 - cash receipts from royalties, fees, commissions and other revenue;
 - cash payments to suppliers for goods and services;
 - cash payments to and on behalf of employees;
 - Cash payment or refunds of income taxes
 - Cash receipts and payments when the contracts are held for dealing or trading purposes
- ❑ An entity may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities.
- ❑ Cash advances and loans made by financial enterprises are usually classified as operating activities.

Investing Activities

- ❑ Expenditures incurred on resources intended to generate future income and cash flows like PPE, Investment in securities, etc.
- ❑ When a contract is accounted for as a hedge of an identifiable position the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.
- ❑ Examples of investing activities :-
 - cash payments or receipts from acquisition or disposal fixed assets (including intangibles).
 - cash payments or receipts from acquisition or disposal of shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than payments for those instruments considered to be cash equivalents and those held for dealing or trading purposes)
 - cash advances and loans made to third parties
 - cash payments or receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities

Financing Activities

- ❑ Cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of funds (both capital and borrowings) to the enterprise.
- ❑ Examples of financing activities :-
 - cash proceeds from issuing shares or other similar instruments
 - cash proceeds from issuing debentures, loans, notes, bonds, and other short or long-term borrowings
 - cash repayments of amounts borrowed.

Reporting of Activities

- ❑ An entity should report cash flows from operating activities using either:
 - the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed
 - the indirect method, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.
- ❑ An entity should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities except to the extent that cash flows which are reported on a net basis.

Reporting of Activities on a net basis

- ❑ Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:
 - a) cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the enterprise
 - b) cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short
- ❑ Examples of the above are-
 - the acceptance and repayment of demand deposits of a bank;
 - rents collected on behalf of, and paid over to, the owners of properties.
 - the purchase and sale of investments
 - other short-term borrowings, for example, those which have a maturity period of three months or less.
 - funds held for customers by an investment enterprise

Reporting of Activities on a net basis

- ❑ Cash flows arising from each of the following activities of a financial enterprise may be reported on a net basis:
 - Cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date
 - placement of deposits with and withdrawal of deposits from other financial institutions
 - Cash advances and loans made to customers and the repayment of those advances and loans

Direct Method

- ❑ The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method.
- ❑ Information about major classes of gross cash receipts and gross cash payments may be obtained either:
 - from the accounting records of the enterprise
 - by adjusting sales, cost of sales and other items in the statement of profit and loss for:
 - changes during the period in inventories and operating receivables and payables;
 - other non-cash items
 - other items for which the cash effects are investing or financing cash flows.

Indirect Method

- ❑ Net cash flow from operating activities is determined by adjusting profit or loss for the effects of:
 - changes during the period in inventories and operating receivables and payables;
 - non-cash items such as depreciation, provisions, etc
 - all other items for which the cash effects are investing or financing cash flows.

Foreign Currency Cash Flows

- Transactions in a foreign currency should be recorded in an enterprise's reporting currency by applying the exchange rate at the date of the cash flow.
- The effect of changes in exchange rates on cash and cash equivalents held in a foreign currency should be reported as a separate part of the reconciliation of the changes in cash and cash equivalents during the period.
- Cash flows denominated in foreign currency are reported in a manner consistent with Accounting Standard (AS) 11
- Unrealised gains and losses arising from changes in foreign exchange rates are not cash flows.

Extraordinary Items, Interest, Dividends and Taxes

- The cash flows associated with extraordinary items should be classified as arising from operating, investing or financing activities as appropriate and separately disclosed.
- Interest and dividends received and paid shall each be disclosed separately.
- Interest paid and interest and dividends received in the case of a financial institution should be classified as operating activities.
- In other cases, interest paid should be classified as financing activities while interest and dividends received should be classified as investing activities
- Dividends paid should be classified as financing activities. (in every case)
- Taxes on income shall be separately disclosed and shall be classified as operating activities unless they can be specifically identified with financing and investing activities. (eg:- DDT on Dividend Paid is classified as Financing Activity)

Investment in Subsidiaries, Associates and Joint Venture

- ❑ Accounting for an investment in an associate or a subsidiary or a joint venture, an investor restricts its reporting in the cash flow statement to the cash flows between itself and the investee/joint venture
- ❑ Cash flows arising from acquisitions and from disposals of subsidiaries or other business units should be presented separately and classified as investing activities.
- ❑ An enterprise should disclose, in aggregate, in respect of both acquisition and disposal of subsidiaries or other business units:
 - total purchase or disposal consideration
 - portion of the purchase or disposal consideration discharged by means of cash and cash equivalents

Other Disclosures

- ❑ Enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.
- ❑ Enterprise should disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the enterprise that are not available for use by it.
- ❑ Additional information as may be relevant to users in understanding the financial position and liquidity of an enterprise.

Issues

- Whether grant received by the government in respect to capital expenditure can be classified as 'Financing Activity'? (EAC Vol 37 Page 72)
- Whether interest collected from customers towards late payment charges can be classified as 'Investing Activity'? (EAC Vol 39 Page 232)

Thank You