Educational Material on Indian Accounting Standard (Ind AS) 7 Statement of Cash Flows

The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

New Delhi

Educational Material on Indian Accounting Standard (Ind AS) 7 Statement of Cash Flows

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

Edition	:	February 2014
Committee/Department	:	Ind AS (IFRS) Implementation Committee
E-mail	:	indas@icai.in
Website	:	www.icai.org
Price	:	₹ 75/-
ISBN	:	978-81-8441-673-2
Published by	:	The Publication Department on behalf of the Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi - 110 002.
Printed by	:	Sahitya Bhawan Publications, Hospital Road, Agra - 282 003. February/2014/1,000 Copies

Foreword

The Institute of Chartered Accountants of India (ICAI) being the premier accounting body in the country has always played a proactive role in establishing a sound financial reporting system in India. As a step in this direction, it was decided to converge national Accounting Standards with International Financial Reporting Standards (IFRS). For smooth transitioning to IFRS-converged Indian Accounting Standards (Ind AS), Ind AS (IFRS) Implementation Committee had been constituted by the ICAI. The primary objective of the Committee is to educate the members and other stakeholders about Ind AS/IFRS so that these Standards may be implemented from a future date, as may be announced by the Ministry of Corporate Affairs (MCA), in the same spirit in which these have been formulated.

The Committee is making every possible effort to enhance the knowledge of members and stakeholders at large about Ind ASs and IFRS. For this purpose, the Committee is engaged in formulation of Educational Materials on Ind ASs. The purpose of an Educational Material is to provide guidance on various issues, which are expected to arise while implementing an Accounting Standard. The Committee has already issued Educational Materials on various Ind ASs. The Committee has now come out with an Educational Material on Ind AS 7, *Statement of Cash Flows*.

I am confident that this publication will provide significant guidance in preparing statement of cash flows in accordance with the provisions of this Standard by explaining the principles enunciated in the Standard through Frequently Asked Questions (FAQs).

I congratulate CA. Shiwaji Bhikaji Zaware, Chairman, Ind AS (IFRS) Implementation Committee for formulating this Educational Material on Ind AS 7, *Statement of Cash Flows*. I would also like to place on record deep appreciation of efforts put in by the Committee in formulation and finalisation of this publication.

I sincerely believe that this Educational Material will be of immense use to the members and others concerned in proper understanding and implementing the Standard. I am confident that all these efforts will be very useful for smooth transitioning to Ind ASs in India.

New Delhi
February 5, 2014

CA. Subodh Kumar Agrawal
President

Preface

The Ind AS (IFRS) Implementation Committee of the Institute of Chartered Accountants of India (ICAI) is making every possible effort to educate the members and other concerned stakeholders to ensure that whenever IFRS-converged Indian Accounting Standards (Ind AS) become effective, the same are implemented in the same spirit in which these have been formulated. One of the initiatives undertaken by the Committee in this regard is issuance of Educational Materials on Ind ASs. An Educational Material on an Ind AS generally contains summary of the respective Standard, Frequently Asked Questions (FAQs), the text of the Standard and comparison with corresponding existing Accounting Standard.

Moving forward in this direction, the Committee has brought out Educational Material on Ind AS 7, *Statement of Cash Flows*. This Standard prescribes requirements for preparation of statement of cash flows which shall be presented as an integral part of the financial statements. This Standard prescribes principles and guidance on preparation and presentation of cash flows of an entity from operating activities, investing activities and financing activities for a reporting period. Information on cash flows is useful in assessing the ability of an entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows.

This Educational Material contains summary of Ind AS 7 discussing the key requirements of the Standard in brief, Frequently Asked Questions (FAQs) covering the issues, which are expected to be encountered frequently while preparing statement of cash flows and case studies illustrating the application of the Standard. The text of Ind AS 7 and significant differences between Ind AS 7 and existing AS 3 has also been included as Appendices to make this publication comprehensive.

I may mention that the views expressed in this publication are the views of the Ind AS (IFRS) Implementation Committee and are not necessarily the views of the Council of the Institute. The purpose of this publication is to provide guidance for implementing this Ind AS effectively by explaining the principles enunciated in the Standard with the help of FAQs. However, while applying Ind ASs in a practical situation, reference should be made to the text of the Standards.

I would also like to place on record my special thanks to our Honourable President CA. Subodh Kumar Agrawal and Vice-President CA. K. Raghu for providing me this opportunity of bringing out implementation guidance on Ind ASs in the form of Educational Materials. I gratefully acknowledge the sincere efforts put in by the Pune-based Study Group comprising CA. Chandrashekhar Balasubramaniam, CA. Prasad Paranjape, CA. C.V.Chitale, CA. Parag Pansare, CA. Nachiket Deo, CA. Ashish Khandelwal and CA. Akshay Oke for developing the draft of this Educational Material. I would like to thank my Council colleagues, co-opted members and special invitees on the Ind AS (IFRS) Implementation Committee for their valuable inputs.

I would like to thank Dr. Avinash Chander, Technical Director, CA. Parminder Kaur, Secretary, Ind AS (IFRS) Implementation Committee, CA. Bibhuti Bhusan Nayak, Executive Officer and other officers of the Secretariat for their efforts and support in bringing out this publication.

I hope this Educational Material will be of immense use in understanding and implementing the provisions of Ind AS 7.

New Delhi
February 5, 2014

CA. Shiwaji Bhikaji Zaware
Chairman
Ind AS (IFRS) Implementation Committee

Contents

Educational Material on Indian Accounting Standard (Ind AS) 7 Statement of Cash Flows

I Ind AS 7 – Summary

Introduction

The balance sheet is a snapshot of entity's financial resources and obligations at a particular point of time and the statement of profit and loss reflects the financial performance for the period. These two components of financial statements are based on accrual basis of accounting. The statement of cash flows includes only inflows and outflows of cash and cash equivalents; it excludes transactions that do not affect cash receipts and payments.

The information on cash flows is useful in assessing sources of generating and deploying cash and cash equivalents during the reporting period. The statement of cash flows can be used for comparison with earlier reporting periods of the same entity as well as comparison with other entities for the same reporting period.

Ind AS 7, *Statement of Cash Flows,* prescribes principles and guidance on preparation and presentation of cash flows of an entity from operating activities, investing activities and financing activities for a reporting period.

Objective

The information about the cash flows of an entity is useful in providing users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents, and the needs of the entity to utilise those cash flows.

The objective of this Standard is to provide information about the historical changes in cash and cash equivalents of an entity during the reporting period from its operating, investing and financing activities.

Scope

An entity is required to prepare a statement of cash flows in accordance with the requirements of this Standard and shall present it as an integral part of its financial statements for each reporting period for which financial statements are prepared.

The users of an entity's financial statements are interested in how the entity generates and uses its cash and cash equivalents. All entities need cash for essentially the same reasons however different their principal revenue-producing activities might be. They need cash to conduct their operations, to pay their obligations and to provide return to their investors. Accordingly, this Standard requires entities to present a statement of cash flows.

Key Requirements of Ind AS 7

The statement of cash flows is required to report cash flows classified by operating, investing and financing activities along with the components of cash and cash equivalents at the beginning and end of the reporting period.

Cash and cash equivalents include demand deposits, certain short-term investments and in some cases, bank overdrafts.

An entity shall report cash flows from operating activities using either the 'direct method' or the 'indirect method'. Under direct method, major classes of gross cash receipts and payments are presented. However, under indirect method, profit or loss is adjusted for the effects of transactions of a non-cash nature; deferrals or accruals of past or future operating cash receipts or payments; and items of income or expenses associated with investing or financing cash flows.

Generally, an entity shall report separately major classes of gross cash receipts and gross cash payments arising from operating, investing and financing activities, except in limited circumstances where cash flows are offset and reported on net basis.

Cash flows arising from taxes on income shall be separately disclosed and classified as cash flow from operating activities unless they can be specifically identified with financing or investing activities.

Foreign currency cash flows are translated at the exchange rates at the dates of the cash flows or using average exchange rate when it is appropriate to do so.

Cash flows from interest and dividends received and paid shall each be disclosed separately. Interest paid and interest and dividend received are classified as operating cash flows for a financial institution. In the case of other entities, interest paid is classified as cash flows from financing activities while interest and dividends received should be classified as cash flows from investing activities. Dividends paid should be classified as cash flows from financing activities for both financial institutions and other entities.

When accounting for an investment in an associate, a joint venture or a subsidiary accounted for by use of the equity or cost method, an investor restricts its reporting in the statement of cash flows to the cash flows between itself and the investee, for example, to dividends and advances.

An entity that reports its interest in an associate or a joint venture using the equity method includes in its statement of cash flows the cash flows in respect of its investments in the associate or joint venture, and distributions and other payments or receipts between it and the associate or joint venture[1].

Cash flows arising from obtaining or losing control of businesses shall be presented separately and classified as investing activities.

[1] Requirements regarding treatment of cash flows in respect of associates and joint ventures have been revised in line with amendments in Ind AS 7 as a consequence of formulation of Ind AS 111, *Joint Arrangements* by the ICAI which is yet to be approved by the MCA.

Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from the statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

Disclosures

An entity shall disclose the components of cash and cash equivalents and shall present a reconciliation of the amounts in its statement of cash flows with equivalent items reported in the balance sheet.

An entity shall disclose, together with a commentary by management, the amount of significant cash and cash equivalents held by the entity that are restricted for specific purposes.

II Frequently Asked Questions

Question 1

Does Ind AS 7 provide any exemption with regard to its applicability like AS 3, which provides that AS 3 is not mandatory for Small and Medium Sized Companies and non-corporate entities falling in Level II and Level III?

Response

No exemption has been provided in Ind AS 7 with regard to its applicability as provided in AS 3. Like other Indian Accounting Standards (Ind ASs), this Standard will be applicable to specified class of companies from the date as may be notified by the Ministry of Corporate Affairs (MCA) in this regard. Moreover, Ind AS 7 provides that statement of cash flows forms an integral part of financial statements for each period for which financial statements are presented. Accordingly, the class of companies which will be required to prepare financial statements as per Ind AS will be required to prepare statement of cash flows as per Ind AS 7.

Question 2

Whether statement of cash flows should be prepared only for annual reporting period?

Response

According to paragraph 1 of Ind AS 7, statement of cash flows forms an integral part of financial statements for each period for which financial statements are presented. According to Ind AS 1, *Presentation of Financial Statements,* complete set of financial statements include among other statements, a statement of cash flows for the period.

From the above, it is clear that statement of cash flows is an integral part of financial statements and the same should be prepared for each

period for which financial statements are presented i.e., annual period as well as interim reporting period.

In this regard, it may be noted that Ind AS 34, *Interim Financial Reporting,* states that interim financial report shall comply with all of the requirements of Indian Accounting Standards. Ind AS 34 provides that interim financial report means a financial report containing either a complete set of financial statements or a set of condensed financial statements for an interim period. Accordingly, statement of cash flows can be presented in complete or condensed form.

Question 3

When an item qualifies to be a cash equivalent?

Response

According to paragraph 6 of Ind AS 7, 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 change in value.

Cash equivalents are held for the purpose of meeting short-term cash requirements rather than for investment or other purposes. An investment normally qualifies to be a cash equivalent only when it has a short maturity (say not more than three months) from the date of acquisition, readily convertible to a know amount of cash and is subject to an insignificant risk of changes in value. An investment is said to be readily convertible when the amount of cash that will be received is known at the time of initial investment.

Examples of cash equivalents:

- Balances with bank in short-term deposits say not more than three months.

- Short-term money market instruments, such as, 91 days' treasury bills, certificate of deposit, etc.

An overriding test is that cash equivalents are held to meet short-term cash requirements of the entity rather than for investment or other purposes. For example, a three month loan or deposit given to a party to help in managing party's short-term liquidity position is not a cash equivalent because it is given for a purpose other than to manage its own short-term cash requirements.

In view of variety of cash management practices and banking arrangements, an entity is required to disclose the policy which it adopts in determining the composition of cash and cash equivalents.

Question 4

Cash is defined as cash on hand and demand deposits. What is the meaning of the term 'demand deposit'? State the treatment of demand deposits?

Response

Ind AS 7 does not define the term 'demand deposit'.

In commercial parlance, demand deposit refers to a deposit in an account held at a bank/financial institution where the amount deposited can be withdrawn at any time by the depositor without any penalty. Examples of such deposit accounts are, current accounts, savings accounts etc. The purpose of making a demand deposit is to meet the short-term fund requirements. Such deposits have same level of liquidity as cash. Accordingly, demand deposits are included in cash.

Question 5

What is meant by 'term deposit'? State the treatment of term deposits?

Response

Term deposit is a deposit held at a bank/financial institution at an agreed rate of interest for fixed period of time. The money so deposited along with the interest at agreed rate can be withdrawn at the end of such

period, or amount deposited can be withdrawn earlier along with interest at lower rate for the period for which the deposit was held.

Term deposit can be for short-term or long-term. Short-term deposits (say, not more than three months) are held with an intention to meet the short-term fund requirements. Since short-term deposits are highly liquid investments that are readily convertible into known amounts of cash and are subject to insignificant risk of changes in value, the same qualify to be a cash equivalent.

The three months maturity period is to be determined from the date of deposit and not from the end of the reporting period, i.e., for a term deposit to qualify to be a cash equivalent, it should have original maturity of period less than three months.

However, term deposits placed for a specified long period (say, more than three months) with an intention to meet the long-term fund requirements will not satisfy the definition of cash equivalents. Further, there could be restrictions on withdrawal or early redemption. Accordingly, cash flows from these deposits are classified under investing activities.

Question 6

What do you mean by 'cash flows'? Is it necessary that there should be actual cash inflow/outflow from entity's cash/bank balances?

Response

The dictionary meaning of the word 'flow' means movement. There are two types of cash flows viz., cash inflow and cash outflow. A cash flow transaction must increase or decrease cash and cash equivalents. Examples: receipt from debtors, sale of fixed assets for cash, repayment of term loan etc.

Any transaction which does not have any effect on cash and cash equivalents is outside the purview of statement of cash flows. Examples: conversion of term loan or debt into equity, redemption of

preference shares by conversion into equity, purchase of goods on credit etc.

Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an entity rather than part of operating, investing or financing activities. Examples: cheques/demand drafts deposited in bank, withdrawal or deposit of cash from/in bank, cash invested in short-term deposit classified as cash equivalent etc.

Question 7

What is the difference between 'bank overdraft' and 'cash credit'?

Response

An overdraft is a loan arrangement between the borrower and the bank whereby the bank extends the credit to a maximum amount up to which the customer can write cheques or make withdrawals. It refers to the amount of money borrowed that exceeds the deposits. Bank overdraft facility is granted by bank usually for a short period to accommodate short-term fund requirement. It may be secured by tangible assets or may be a clean overdraft. Overdraft facilities are linked with the operations in current account.

Cash credit is a fund based facility granted by a bank to its customer to finance working capital requirements on a continuing basis. Cash credit is usually secured by hypothecation of inventory and debtors or pledge of goods. It may also be secured by a charge on fixed assets.

With regard to presentation of these items in the statement of cash flows, paragraph 8 of Ind AS 7, provides that bank borrowings are usually considered to be part of financing activities. However, where bank overdrafts which are repayable on demand form an integral part of an entity's cash management, bank overdrafts are included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from positive to being overdrawn.

In accordance with the above, cash credit from bank, a facility on a continuing basis (though contractually payable on demand on violation of terms and conditions of sanction) is considered as a part of financing activities and bank overdraft forming the part of cash management is considered as cash equivalent while preparing the statement of cash flows.

Question 8

What are the examples of cash flows arising from taxes on income to be separately disclosed under cash flows from investing or financing activities?

Response

Cash flows arising from taxes on income shall be separately disclosed and classified as cash flow from operating activities, unless they can be specifically identified with financing and investing activities. Taxes on income arise on transactions that give rise to cash flows that are classified as operating, investing or financing activities in the statement of cash flows.

While tax expense may be identified with investing or financing activities, the related tax cash flows are often impracticable to identify and may arise in a different period from the cash flows of underlying transaction. Therefore, taxes paid are usually classified as cash flows from operating activities. Example: If we strictly go by classification of taxes in accordance with the nature of the related transaction, tax impact of short-term capital gain should be classified as investing activity. Suppose, the entity is incurring business losses, the same gets adjusted against short-term capital gain for tax purposes. Accordingly, showing tax impact of short-term capital gain and business losses separately is impracticable. Therefore, tax paid is usually classified as cash flows from operating activity.

However, where it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows, tax cash flows are classified as investing or financing activities. Examples: tax payment by way of long-term capital gain on sale of land, tax payment on dividend

received from a foreign company shall be classified as investing activity. On the other hand, cash inflow associated with underlying transaction shall be shown on gross basis.

Similarly, dividend distribution tax under section 115-O of Income Tax Act, 1961 viz., preference and equity dividend distribution tax is considered as an integral part of financing activities.

Question 9

What are the examples of cash flows which can be reported on a net basis?

Response

Generally, all cash flows are reported gross. Cash flows are offset and reported net only in limited circumstances. Cash flows arising from the following operating, investing and financing activities may be reported on a net basis:

- cash receipts and payments on behalf of customers when the cash flow reflect the activities of the customer rather than those of the entity; and

- cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.

Examples:

(a) receipt of insurance premium from policy holders and refund of premium on cancellation of general insurance policy to policy holders;

(b) investment and sale of securities by wealth management companies on behalf of customers;

(c) receipts and payments by an agent on behalf of a principal;

(d) acceptance and repayment of deposits with short maturities;

(e) withdrawal and deposits from/in cash credit account with bank.

Cash flows arising from the following activities of a financial institution may be reported on a net basis:

- cash receipts and payments for the acceptance and repayment of deposits with fixed maturity date;
- the placement of deposits with and withdrawal of deposits from other financial institutions;
- cash advances and loans made to customers and repayment of those advances and loans.

Question 10

What is the preferred method to report cash flows from operating activities?

Response

An entity shall report cash flows from operating activities using either the 'direct method' or the 'indirect method'.

According to Ind AS 7, the entities are encouraged to report cash flows from operating activities using the 'direct method' as it provides information which may be useful in estimating future cash flows and which is not available under the 'indirect method'.

Under direct method, major classes of gross cash receipts and payments are disclosed. However, under indirect method, profit or loss is adjusted for the effects of transactions of a non-cash nature; deferrals or accruals of past or future operating cash receipts or payments; and items of income or expenses associated with investing or financing cash flows.

Principally, final reporting conclusions under both methods are the same; an entity may follow either the direct method or indirect method.

Considering voluminous operating transactions of commercial entities, it is difficult to prepare statement of cash flows under direct method as both cash as well as non-cash transactions are recorded in the books of account under accrual system of accounting.

Insurance Regulatory and Development Authority (IRDA) in its master circular on preparation of financial statements of general and life insurance business has specified that all insurers are required to present the statement of cash flows as per the direct method.

According to Clause 32 of the listing agreement specified by SEBI, all listed companies are required to present the statement of cash flows as per the indirect method.

Question 11

Which rate should be used in translating the cash flows denominated in a foreign currency? What is the treatment of unrealised gains and losses arising from changes in foreign currency exchange rates?

Response

Cash flows arising from the transactions in a foreign currency shall be recorded in an entity's functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of cash flow. Cash flows denominated in a foreign currency are reported in a manner consistent with Ind AS 21, *The Effects of Changes in Foreign Exchange Rates*. For practical reasons, Ind AS 21 permits the use of an exchange rate that approximates the actual rate, for example, an average rate for a week or a month may be used for all transactions in each foreign currency occurring during that period.

Unrealised gains and losses arising from changes in foreign exchange rates do not give rise to actual inflow or outflow of cash or cash equivalents. However, the effect of such exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported separately from cash flows from operating, investing and financing activities in the statement of cash flows in order to reconcile cash and

cash equivalents as per the statement of cash flows with cash and cash equivalents as per the balance sheet.

Question 12

What is the classification for interest and dividend paid and received in the statement of cash flows? How are lease payments under finance lease and payment towards acquiring a fixed asset on deferred payment basis presented in the statement of cash flows?

Response

An entity presents cash flows from operating, investing and financing activities in a manner which is most appropriate to its business. The classification by activity provides information that allows users to assess the impact of those activities on the financial position of the entity and the amount of its cash and cash equivalents.

The following are the examples of classification of various activities:

Particulars	**Classification for reporting cash flows**	
	Banks and financial institutions	**Other entities**
Interest received on loans and advances given	Operating activities	Investing activities
Interest paid on deposits and other borrowings	Operating activities	Financing activities
Dividend received on investment in bonds and shares	Operating activities	Investing activities
Interest and dividend received on investments in subsidiaries, associates and in other entities	Investing activities	Investing activities
Dividend paid on preference and equity shares, including tax on dividend paid on preference and equity shares by other entities	Financing activities	Financing activities

Finance charges paid by lessee under finance lease	Financing activities	Financing activities
Interest paid and capitalised as per Ind AS 23, *Borrowing Costs*	Investing activities	Investing activities
Payment towards reduction of outstanding finance lease liability	Financing activities	Financing activities
Interest paid to vendor for acquiring fixed asset under deferred payment basis	Financing activities	Financing activities
Principal sum payment under deferred payment basis for acquisition of fixed assets	Investing activities	Investing activities
Penal interest received from customers for late payments	Operating activities	Operating activities
Penal interest paid to suppliers for late payments	Operating activities	Operating activities
Interest paid on delayed tax payments	Operating activities	Operating activities
Interest received on tax refunds	Operating activities	Operating activities

Question 13

What are the examples of cash and cash equivalent balances held by the entity that are not available for use?

Response

Ind AS 7 requires an entity to disclose together with management commentary, the amount of significant cash and cash equivalent balances held by the entity that are not available for use. The examples are as follows:

(a) balance in unpaid dividend account;

(b) balance in bank account for share application money, pending allotment of shares;

(c) earmarked bank balances for specific purposes. Examples: bank account for debenture redemption, dividend payment etc.

(d) balance in bank account subject to legal restrictions.

Question 14

Provide illustrative examples where reconciliation statement is required to be disclosed between the amounts in the statement of cash flows with the equivalent items reported in the balance sheet.

Response

Paragraph 45 of Ind AS 7 requires the disclosure of components of cash and cash equivalents in the statement of cash flows. These amounts should be reconciled with the equivalents items reported in the balance sheet. Reconciliation may be required for certain items, such as, bank overdrafts which are repayable on demand form an integral part of an entity's cash management, are included as a component of cash and cash equivalents in the statement of cash flows. However, bank overdrafts will be included in financial liabilities in balance sheet. Accordingly, such bank overdrafts could be one element of reconciliation. Where the reporting entity holds foreign currency cash and cash equivalent balances, these are monetary items that will be restated at the reporting date in accordance with Ind AS 21, *The Effects of Changes in Foreign Exchange Rates*. Any exchange differences arising on translation will increase or decrease these balances but will not give rise to cash flows. Accordingly, such unrealised gains or losses arising from changes in foreign currency exchange rates could be another element of reconciliation.

Question 15

How should the sale proceeds from a sale and leaseback transaction be reported in the statement of cash flows?

Response

A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset. The accounting treatment of cash flows arising from the sale proceeds of a sale and leaseback transaction depends upon the type of lease involved. If the leaseback is a finance lease, then the transaction is a financial arrangement between the lessor and the lessee in substance, whereby the lessor provides finance to the lessee with the asset as security. Accordingly, in such a case sale proceeds of the asset should be classified as financing activities in the statement of cash flows. Lease finance charges and repayment of lease principal in the future are also required to be reported in the statement of cash flows as financing activities.

If the leaseback is a operating lease, cash flows arising from sale proceeds of the fixed assets should be recorded as investing activities. The lease payments to be made in future would be classified as cash flows from operating activities.

Question 16

How debt securities purchased at a discount/premium are classified in the statement of cash flows?

Response

Cash flows from investing activities represent the extent to which expenditure has been made for resources intended to generate future income and cash flows. Thus, actual cash outflow irrespective of discount or premium will be presented as investing activity. Example: bonds of face value of Rs. 5,25,000 are purchased in the market at a discount for Rs. 5,21,500. In this case, cash outflow of Rs. 5,21,500 will be presented in the statement of cash flows under investing activities.

Question 17

How taxes such as Value Added Tax (VAT), Service Tax etc., collected from customers on behalf of government authorities should be presented in the statement of cash flows?

Response

Ind AS 7 does not provide specific guidance on the presentation of cash flows from taxes that are collected from customers on behalf of government authorities.

The taxes collected from customers on behalf of government authorities, such as, VAT or Service Tax, do not form part of entity's revenue. In the statement of cash flows, such taxes should be presented net of amounts remitted to government authorities as a separate line item to show the impact of such taxes on cash flows under operating activities.

Question 18

What is the presentation of cash flows arising out of payments for manufacture or acquisition of assets held for rental to others and subsequently held for sale in the ordinary course of business?

Response

There are certain types of entities whose ordinary activities include routinely renting out assets to others and selling the assets subsequently in the ordinary course of business. The proceeds from the sale of such assets are recognised as revenue in accordance with the Ind AS 18, *Revenue*. The derecognition principles of such assets are described in paragraph 68A of Ind AS 16, *Property, Plant and Equipment*.

Paragraph 14 of Ind AS 7, inter alia, states that cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale as described in paragraph 68A of Ind AS 16, *Property, Plant and Equipment* are cash flow from operating activities. The cash receipts from rent and subsequent sale of such assets are also cash flows from operating activities.

Therefore, cash flows associated with these type of assets are classified as cash flows arising from operating activities. This is in contrast with the normal classification where cash payments made to acquire or manufacture property, plant and equipment and cash receipts from the sale of such assets are classified as investing activities.

Question 19

Whether comparative figures are required to be presented in the statement of cash flows?

Response

An entity is required to present statement of cash flows for the current period classifying the cash flows from operating, investing and financing activities with corresponding figures of earlier reporting period for comparison and analysis unless otherwise exempted.

Question 20

How do you classify purchase and sale of securities in the statement of cash flows?

Response

An entity presents cash flows from operating, investing and financing activities in a manner which is most appropriate to its business.

An entity may hold securities for dealing or trading purposes as they relate to the main revenue generating activity of the entity. In such cases, these are inventories acquired for resale. Accordingly, in this scenario, cash flows arising from the purchase and sale of such securities are classified as operating activities.

Cash flows arising from the purchase and sale of securities held as investments are classified as investing activities.

Question 21

How do you classify cash receipts and payments arising out of future contracts, forward contracts, option contracts and swap contracts?

Response

Paragraph 16 of Ind AS 7, amongst other examples of cash flows arising from investing activities, provides as follows:

"(g) cash payments for 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; and

(h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for trading purposes, or the receipts are classified as financing activities.

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."

From the above paragraphs, it is clear that classification of cash flows from future contracts, forward contracts, option contracts and swap contracts depends on whether a contract is accounted for as a hedging instrument for hedged item or not.

When such a contract is accounted for as a hedge, cash flows arising from hedging instruments are classified as operating, investing or financing activities, on the basis of the classification of the cash flows arising from the hedged item. Example: when a forward contract is taken for repayment of a foreign currency loan and hedge accounting is followed, cash payments and receipts of the aforesaid forward contract is classified as financing activities.

When these contracts are not accounted for as hedge, the classification of cash flows depends on the nature of the contract itself, i.e., if these contracts are held for dealing or trading purposes, cash flows arising from such transactions should be classified as cash flows from operating activities. Otherwise, the cash flows will be classified as investing activities except where cash flows are classified as financing activities.

Question 22

An entity invests in a 10 year bond with a face value of Rs. 6,00,000 by paying Rs. 2,31,500. The effective rate of interest is 10%. An entity recognises proportionate interest income in its statement of profit and loss over the period of bond.

How the interest income will be treated in the statement of cash flows during the period of bond?

How the maturity proceeds of Rs. 6,00,000 will be treated in the statement of cash flows?

The entity is not in the business of dealing in securities.

Response

In the given case, since the entity is not in the business of dealing in securities, a sum of Rs. 2,31,500 invested in a bond will be classified as investing activities. There is no cash flow of interest during bond period, as there is no cash receipt. On maturity, proceeds of Rs. 6,00,000 will be classified as investing activity with a bifurcation of Rs. 3,68,500 as interest and Rs. 2,31,500 as proceeds towards redemption of bond.

Question 23

Ind AS 7 requires disclosure of non-cash transactions in the financial statements. Give examples of non-cash transactions?

Response

Investing and financing transactions that do not require the use of cash and cash equivalents are excluded from the statement of cash flows. Such transactions are however required to be disclosed elsewhere in the financial statements in a way that provides all the relevant information. The disclosure of these significant non-cash transactions is made by way of notes to the financial statements.

Examples of non-cash transactions:

(a) acquisition of an enterprise by means of issue of equity shares;

(b) conversion of debentures or preference shares into equity shares;

(c) conversion of term loan into equity shares;

(d) issue of bonus shares;

(e) reduction of capital under restructuring or reduction of capital;

(f) exchange of assets.

Question 24

What is the meaning of 'contributed equity' used in the definition of financing activities?

Response

Ind AS 7 defines financing activities as activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

In accounting and finance terms, equity is the residual interest of shareholders in assets after deducting all liabilities. Thus, equity = shareholders' funds or total assets – liabilities.

Shareholders' funds = share capital + reserves and surplus + money received against share warrants

Thus, equity is built up by two ways:

- Contributed equity
- Retained earnings

Thus, contributed equity is paid up capital contributed by shareholders of the company. Cash flows arising from changes in contributed equity on account of issue of additional capital, buy back of shares etc. are classified as financing activities.

The change in retained earnings is primarily on account of profit or loss earned by the entity. Profits are earned from principal revenue-producing activities and other activities.

Question 25

Ind AS 7 uses the term 'financial institution', which has not been defined in the Standard. What is the meaning of this term?

Response

The term 'financial institution' is not defined in the Standard. In the absence of a specific definition, following definitions of 'financial institution' can be taken as a basis to determine whether the activities of an entity are in the nature of financial institution or not:

Section 2(39) of the Companies Act, 2013, states that 'financial institution' includes a scheduled bank, and any other financial institution defined or notified under the Reserve Bank of India Act, 1934.

Section 45-I of the Reserve Bank of India Act, 1934, defines financial institution as under:

"financial institution" means any non-banking institution which carries on as its business or part of its business any of the following activities, namely:

(i) the financing, whether by way of making loans or advances or otherwise, of any activity other than its own;

(ii) the acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature;

(iii) letting or delivering of any goods to a hirer under a hire-purchase agreement as defined in clause (c) of section 2 of the Hire-Purchase Act, 1972;

(iv) the carrying on of any class of insurance business;

(v) managing, conducting or supervising, as foreman, agent or in any other capacity, of chits or kuries as defined in any law which is for the time being in force in any State, or any business, which is similar thereto;

(vi) collecting, for any purpose or under any scheme or arrangement by whatever name called monies in lump sum or otherwise, by way of subscriptions or by sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing monies in any other way, to persons from whom monies are collected or to any other person, but does not include any institution, which carries on as its principal business:

(a) agricultural operations; or

(aa) industrial activity; or;

(b) the purchase or sale of any goods (other than securities) or the providing of any services; or

(c) the purchase, construction or sale of immovable property, so however, that no portion of the income of the institution is derived from the financing of purchases, constructions or sales of immovable property by other persons.

[Explanation — For the purpose of this clause, ''industrial activity'' means any activity specified in sub-clauses (i) to (xviii) of clause (c) of Section 2 of the Industrial Development Bank of India Act, 1964]

Question 26

Explain how securitisation of receivables is presented in the statement of cash flows in the books of originator?

Response

There is no guidance in Ind AS 7 with regard to presentation of cash flows from securitisations. In this regard, it may be noted that derecognition of receivables in the books of the originator in accordance with the requirements laid down in Ind AS 39, *Financial Instruments: Recognition and Measurement,* implies that, in substance it is similar to sale of receivables. Amount received from such securitisations can be considered as early collection of amounts due from customers. Accordingly, cash flows arising from proceeds from securitisation activities derecognised in accordance with the requirements of Ind AS 39 should be classified as part of operating activities even if the entity does not enter into such transactions regularly.

In other cases, where the receivables are not derecognised in the books of the originator in accordance with the requirements of Ind AS 39, the proceeds from securitisation arrangement are recognised as a liability. Therefore, cash flows arising from such transactions should be classified as part of financing activities.

III Case Studies

Case Study 1: Foreign currency cash flows

Entity A, whose functional currency is Indian Rupee, had a balance of cash and cash equivalents of Rs. 2,00,000, but no trade receivables or trade payables on January 1, 20X2. During 20X2, the entity entered into the following foreign currency transactions:

- Entity A purchased goods for resale from Europe for €1,00,000 when the exchange rate was €1 = Rs. 50. This balance is still unpaid at December 31, 20X2 when the exchange rate is €1 = Rs. 45. An exchange gain on retranslation of the trade payable of Rs. 5,00,000 is recorded in profit or loss [€1,00,000 x (50 – 45) = Rs. 5,00,000].

- Entity A sold the goods to an American client for $ 1,50,000 when the exchange rate was $1 = Rs. 40. This amount was settled when the exchange rate was $1 = Rs. 42. A further exchange gain of Rs. 3,00,000 regarding the trade receivable is recorded in the statement of profit or loss [$ 1,50,000 x (42 – 40) = Rs. 3,00,000].

- Entity A also borrowed €1,00,000 under a long-term loan agreement when the exchange rate was €1 = Rs. 50 and immediately converted it to Rs. 50,00,000. The loan was retranslated at December 31, 20X2 @ Rs. 45 = Rs. 45,00,000, with a further exchange gain of Rs. 5,00,000 recorded in the statement of profit or loss.

- Entity A therefore records a cumulative exchange gain of Rs. 13,00,000 (5,00,000 + 3,00,000 + 5,00,000) in arriving at its profit for the year.

In addition, Entity A records a gross profit of Rs. 10,00,000 (Rs. 60,00,000 – Rs. 50,00,000) on the sale of the goods.

How cash flows arising from above transactions would be reported in the statement of cash flows under indirect method?

Response

Indirect method of statement of cash flows

Cash flows from operating activities

Particulars	**Amount (Rs.)**
Profit before taxation (18,00,000 + 10,00,000)	23,00,000
Adjustment for unrealised exchange gains/losses:	
Foreign exchange gain on long term loan	(5,00,000)
Decrease in trade payables	(5,00,000)
Net cash inflow from operating activities	**13,00,000**
Cash inflow from financing activity	**50,00,000**
Net increase in cash and cash equivalents	**63,00,000**
Cash and cash equivalents at the beginning of the period	2,00,000
Cash and cash equivalents at the end of the period	**65,00,000**

Case Study 2: Subsidiary acquired in the year

Entity A acquired a subsidiary, entity B, during the year. Summarised information from the consolidated statement of profit and loss and balance sheet is provided, together with some supplementary information, to demonstrate how the statement of cash flows under the indirect method is derived.

Consolidated statement of profit and loss	**Amount (Rs.)**
Revenue	3,80,000
Cost of sales	(2,20,000)
Gross profit	1,60,000
Depreciation	(30,000)
Other operating expenses	(56,000)
Interest cost	(4,000)
Profit before taxation	**70,000**
Taxation	(15,000)
Profit after taxation	**55,000**

Consolidated balance sheet	**2013 Amount (Rs.)**	**2012 Amount (Rs.)**
Assets		
Cash and cash equivalents	8,000	5,000
Trade receivables	54,000	50,000
Inventories	30,000	35,000
Property, plant and equipment	1,60,000	80,000
Goodwill	18,000	-
Total assets	2,70,000	1,70,000
Liabilities		
Trade payables	68,000	60,000

Income tax payable	12,000	11,000
Long term debt	1,00,000	64,000
Total liabilities	**1,80,000**	**1,35,000**
Shareholders' equity	**90,000**	**35,000**
Total liabilities and shareholders'	**2,70,000**	**1,70,000**

Other information

All of the shares of entity B were acquired for Rs. 74,000 in cash. The fair values of assets acquired and liabilities assumed were:

Particulars	**Amount (Rs.)**
Inventories	4,000
Trade receivables	8,000
Cash	2,000
Property, plant and equipment	1,10,000
Trade payables	(32,000)
Long term debt	(36,000)
Goodwill	18,000
Cash consideration paid	**74,000**

Prepare statement of cash flows.

Response

This information will be incorporated into the consolidated statement of cash flows as follows:

Statement of cash flows for 2013 (extract)	**Amount (Rs.)**	**Amount (Rs.)**
Cash flows from opening activities		
Profit before taxation	70,000	
Adjustments for non-cash items:		
Depreciation	30,000	

Decrease in inventories (Note 1)	9,000	
Decrease in trade receivables (Note 2)	4,000	
Decrease in trade payables (Note 3)	(24,000)	
Interest paid to be included in financing activities	4,000	
	23,000	
Taxation (11,000 + 15,000 – 12,000)	(14,000)	
Net cash inflow from operating activities		79,000
Cash flows from investing activities		
Cash paid to acquire subsidiary (74,000–2,000)	(72,000)	
Net cash outflow from investing activities		(72,000)
Cash flows from financing activities		
Interest paid	(4,000)	
Net cash outflow from financing activities		(4,000)
Increase in cash and cash equivalents		**3,000**
Cash and cash equivalents, beginning of year		**5,000**
Cash and cash equivalents, end of year		**8,000**

Note 1:

Total inventories of the Group at the end of the year	Rs. 30,000
Inventories acquired during the year from subsidiary	(Rs. 4,000)
	Rs. 26,000
Opening inventory	Rs. 35,000
Decrease in inventory	Rs. 9,000

Note 2:

Total trade receivable of the Group at the end of the year	Rs. 54,000
Trade receivables acquired during the year from subsidiary	(Rs. 8,000)
	Rs. 46,000
Opening trade receivable	Rs. 50,000
Decrease in trade receivable	Rs. 4,000

Note 3:

Trade payables at the end of the year	Rs. 68,000
Trade payables of the subsidiary assumed during the year	(Rs. 32,000)
	Rs. 36,000
Opening trade payable	Rs. 60,000
Decrease in trade payables	Rs. 24,000

Appendices

Appendix I

Indian Accounting Standard (Ind AS) 7

Statement of Cash Flows

Contents

Indian Accounting Standard (Ind AS) 7

Statement of Cash Flows

*(This Indian Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)*

Objective

Information about the cash flows of an entity is useful in providing users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an entity to generate cash and cash equivalents and the timing and certainty of their generation.

The objective of this Standard is to require the provision of information about the historical changes in cash and cash equivalents of an entity by means of a statement of cash flows which classifies cash flows during the period from operating, investing and financing activities.

Scope

1 An entity shall prepare a statement of cash flows in accordance with the requirements of this Standard and shall present it as an integral part of its financial statements for each period for which financial statements are presented.

2 [Refer to Appendix 1]

3 Users of an entity's financial statements are interested in how the entity generates and uses cash and cash equivalents. This is the case regardless of the nature of the entity's activities and irrespective of whether cash can be viewed as the product of the entity, as may be

the case with a financial institution. Entities need cash for essentially the same reasons however different their principal revenue-producing activities might be. They need cash to conduct their operations, to pay their obligations, and to provide returns to their investors. Accordingly, this Standard requires all entities to present a statement of cash flows.

Benefits of cash flow information

4 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. Cash flow information is useful in assessing the ability of the entity to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different entities. It also enhances the comparability of the reporting of operating performance by different entities because it eliminates the effects of using different accounting treatments for the same transactions and events.

5 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.

Definitions

6 The following terms are used in this Standard with the meanings specified:

> *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 entity 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 contributed equity and borrowings of the entity.**

Cash and cash equivalents

7 Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preference shares acquired within a short period of their maturity and with a specified redemption date.

8 Bank borrowings are generally considered to be financing activities. However, where bank overdrafts which are repayable on demand form an integral part of an entity's cash management, bank overdrafts are included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn.

9 Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an entity rather than part of its operating, investing

and financing activities. Cash management includes the investment of excess cash in cash equivalents.

Presentation of a statement of cash flows

10 The statement of cash flows shall report cash flows during the period classified by operating, investing and financing activities.

11 An entity presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the entity and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.

12 A single transaction may include cash flows that are classified differently. For example, when the instalment paid in respect of a fixed asset acquired on deferred payment basis includes both interest and loan, the interest element is classified under financing activities and the loan element is classified under investing activities.

Operating activities

13 The amount of cash flows arising from operating activities is a key indicator of the extent to which the operations of the entity have generated sufficient cash flows to repay loans, maintain the operating capability of the entity, pay dividends and make new investments without recourse to external sources of financing. Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows.

14 Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Therefore, they generally result from the transactions and other events that enter into the determination of profit or loss. Examples of cash flows from operating activities are:

(a) cash receipts from the sale of goods and the rendering of services;

(b) cash receipts from royalties, fees, commissions and other revenue;

(c) cash payments to suppliers for goods and services;

(d) cash payments to and on behalf of employees;

(e) cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits;

(f) cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and

(g) cash receipts and payments from contracts held for dealing or trading purposes.

Some transactions, such as the sale of an item of plant, may give rise to a gain or loss that is included in recognised profit or loss. The cash flows relating to such transactions are cash flows from investing activities. However, cash payments to manufacture or acquire assets held for rental to others and subsequently held for rental to others and subsequently held for sale as described in paragraph 68A of Ind AS 16 *Property, Plant and Equipment* are cash flows from operating activities. The cash receipts from rents and subsequent sales of such assets are also cash flows from operating activities.

15 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. Similarly, cash advances and loans made by financial institutions are usually classified as operating activities since they relate to the main revenue-producing activity of that entity.

Investing activities

16 The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Only expenditures that result in a recognized asset in the balance sheet are eligible for classification as

investing activities. Examples of cash flows arising from investing activities are:

(a) cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalised development costs and self-constructed property, plant and equipment;

(b) cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;

(c) cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);

(d) cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);

(e) cash advances and loans made to other parties (other than advances and loans made by a financial institution);

(f) cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);

(g) cash payments for 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; and

(h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

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.

Financing activities

17 The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of capital to the entity. Examples of cash flows arising from financing activities are:

(a) cash proceeds from issuing shares or other equity instruments;

(b) cash payments to owners to acquire or redeem the entity's shares;

(c) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;

(d) cash repayments of amounts borrowed; and

(e) cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

Reporting cash flows from operating activities

18 An entity shall report cash flows from operating activities using either:

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) 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.

19 Entities are encouraged to report cash flows from operating activities using the 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. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:

(a) from the accounting records of the entity; or

(b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial institution) and other items in the statement of profit and loss for:

(i) changes during the period in inventories and operating receivables and payables;

(ii) other non-cash items; and

(iii) other items for which the cash effects are investing or financing cash flows.

20 Under the indirect method, the net cash flow from operating activities is determined by adjusting profit or loss for the effects of:

(a) changes during the period in inventories and operating receivables and payables;

(b) non-cash items such as depreciation, provisions, deferred taxes, unrealised foreign currency gains and losses, and undistributed profits of associates; and

(c) all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the revenues and expenses disclosed in the statement of profit and loss and the changes during the period in inventories and operating receivables and payables.

Reporting cash flows from investing and financing activities

21 An entity shall 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 described in paragraphs 22 and 24 are reported on a net basis.

Reporting cash flows on a net basis

22 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 entity; and

(b) cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.

23 Examples of cash receipts and payments referred to in paragraph 22(a) are:

(a) the acceptance and repayment of demand deposits of a bank;

(b) funds held for customers by an investment entity; and

(c) rents collected on behalf of, and paid over to, the owners of properties.

23A Examples of cash receipts and payments referred to in paragraph 22(b) are advances made for, and the repayment of:

(a) principal amounts relating to credit card customers;

(b) the purchase and sale of investments; and

(c) other short-term borrowings, for example, those which have a maturity period of three months or less.

24 Cash flows arising from each of the following activities of a financial institution may be reported on a net basis:

(a) cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;

(b) the placement of deposits with and withdrawal of deposits from other financial institutions; and

(c) cash advances and loans made to customers and the repayment of those advances and loans.

Foreign currency cash flows

25 Cash flows arising from transactions in a foreign currency shall be recorded in an entity's functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

26 The cash flows of a foreign subsidiary shall be translated at the exchange rates between the functional currency and the foreign currency at the dates of the cash flows.

27 Cash flows denominated in a foreign currency are reported in a manner consistent with Ind AS 21 The *Effects of Changes in Foreign Exchange Rates.* This permits the use of an exchange rate that approximates the actual rate. For example, a weighted average exchange rate for a period may be used for recording foreign currency transactions or the translation of the cash flows of a foreign subsidiary. However, Ind AS 21 does not permit use of the exchange rate at the end of the reporting period when translating the cash flows of a foreign subsidiary.

28 Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the statement of cash flows in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at end of period exchange rates.

29 [Refer to Appendix 1]

30 [Refer to Appendix 1]

Interest and dividends

31 Cash flows from interest and dividends received and paid shall each be disclosed separately. Cash flows arising from interest paid and interest and dividends received in the case of a financial institution should be classified as cash flows arising from operating activities. In the case of other entities, cash flows arising from interest paid should be classified as cash flows from financing activities while interest and dividends received should be classified as cash flows from investing activities. Dividends paid should be classified as cash flows from financing activities.

32 The total amount of interest paid during a period is disclosed in the statement of cash flows whether it has been recognised as an expense in profit or loss or capitalised in accordance with Ind AS 23 *Borrowing Costs*.

33 Interest paid and interest and dividends received are usually classified as operating cash flows for a financial institution. However, there is no consensus on the classification of these cash flows for other entities. Some argue that interest paid and interest and dividends received may be classified as operating cash flows because they enter into the determination of profit or loss. However, it is more appropriate that interest paid and interest and dividends received are classified as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.

34 Some argue that dividends paid may be classified as a component of cash flows from operating activities in order to assist users to determine the ability of an entity to pay dividends out of operating cash flows. However, it is considered more appropriate that dividends paid should be classified as cash flows from financing activities because they are cost of obtaining financial resources.

Taxes on income

35 Cash flows arising from taxes on income shall be separately disclosed and shall be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.

36 Taxes on income arise on transactions that give rise to cash flows that are classified as operating, investing or financing activities in a statement of cash flows. While tax expense may be readily identifiable with investing or financing activities, the related tax cash flows are often impracticable to identify and may arise in a different period from the cash flows of the underlying transaction. Therefore, taxes paid are usually classified as cash flows from operating activities. However, when it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows that are classified as investing or financing activities the tax cash flow is classified as an investing or financing activity as appropriate. When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed.

Investments in subsidiaries, associates and joint ventures

37 When accounting for an investment in an associate, a joint venture or a subsidiary accounted for by use of the equity or cost method, an investor restricts its reporting in the statement of cash flows to the cash flows between itself and the investee, for example, to dividends and advances.

38 An entity that reports its interest in an associate or a joint venture using the equity method includes in its statement of cash flows the cash flows in respect of its investments in the associate or joint venture, and distributions and other payments or receipts between it and the associate or joint venture.[1]

[1] Paragraph 37 and 38 of Ind AS 7 hosted on the MCA's website have been revised in line with amendments made in Ind AS 7 as a consequence of formulation of Ind AS 111, *Joint Arrangements* by the ICAI which is yet to be approved by the MCA.

Changes in ownership interests in subsidiaries and other businesses

39 The aggregate cash flows arising from obtaining or losing control of subsidiaries or other businesses shall be presented separately and classified as investing activities.

40 An entity shall disclose, in aggregate, in respect of both obtaining and losing control of subsidiaries or other businesses during the period each of the following:

(a) the total consideration paid or received;

(b) the portion of the consideration consisting of cash and cash equivalents;

(c) the amount of cash and cash equivalents in the subsidiaries or other businesses over which control is obtained or lost; and

(d) the amount of the assets and liabilities other than cash or cash equivalents in the subsidiaries or other businesses over which control is obtained or lost, summarised by each major category.

41 The separate presentation of the cash flow effects of obtaining or losing control of subsidiaries or other businesses as single line items, together with the separate disclosure of the amounts of assets and liabilities acquired or disposed of, helps to distinguish those cash flows from the cash flows arising from the other operating, investing and financing activities. The cash flow effects of losing control are not deducted from those of obtaining control.

42 The aggregate amount of the cash paid or received as consideration for obtaining or losing control of subsidiaries or other businesses is reported in the statement of cash flows net of cash and cash equivalents acquired or disposed of as part of such transactions, events or changes in circumstances.

42A Cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control shall be classified as cash flows from financing activities.

42B Changes in ownership interests in a subsidiary that do not result in a loss of control, such as the subsequent purchase or sale by a parent of a subsidiary's equity instruments, are accounted for as equity transactions (see Ind AS 110 *Consolidated Financial Statements*). Accordingly, the resulting cash flows are classified in the same way as other transactions with owners described in paragraph 17[2].

Non-cash transactions

43 Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

44 Many investing and financing activities do not have a direct impact on current cash flows although they do affect the capital and asset structure of an entity. The exclusion of non-cash transactions from the statement of cash flows is consistent with the objective of a statement of cash flows as these items do not involve cash flows in the current period. Examples of non-cash transactions are:

(a) the acquisition of assets either by assuming directly related liabilities or by means of a finance lease;

(b) the acquisition of an entity by means of an equity issue; and

(c) the conversion of debt to equity.

[2] Reference to relevant Ind AS has been revised as a consequence of formulation of Ind AS 110, *Consolidated Financial Statements*, by the ICAI which is yet to be approved by the MCA.

Components of cash and cash equivalents

45 An entity shall disclose the components of cash and cash equivalents and shall present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in the balance sheet.

46 In view of the variety of cash management practices and banking arrangements around the world and in order to comply with Ind AS 1 *Presentation of Financial Statements*, an entity discloses the policy which it adopts in determining the composition of cash and cash equivalents.

47 The effect of any change in the policy for determining components of cash and cash equivalents, for example, a change in the classification of financial instruments previously considered to be part of an entity's investment portfolio, is reported in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

Other disclosures

48 An entity shall disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group[3].

49 There are various circumstances in which cash and cash equivalent balances held by an entity are not available for use by the group[4]. Examples include cash and cash equivalent balances held by a subsidiary that operates in a country where exchange controls or other legal restrictions apply when the balances are not available for general use by the parent or other subsidiaries.

50 Additional information may be relevant to users in understanding the financial position and liquidity of an entity. Disclosure of this

[3] The requirements shall be equally applicable to the entities in case of separate financial statements also.

[4] *Ibid.*

information, together with a commentary by management, is encouraged and 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;

(b) the aggregate amounts of the cash flows from each of operating, investing and financing activities related to interests in joint ventures reported using proportionate consolidation;

(c) the aggregate amount of cash flows that represent increases in operating capacity separately from those cash flows that are required to maintain operating capacity; and

(d) the amount of the cash flows arising from the operating, investing and financing activities of each reportable segment (see Ind AS 108 *Operating Segments)*.

51 The separate disclosure of cash flows that represent increases in operating capacity and cash flows that are required to maintain operating capacity is useful in enabling the user to determine whether the entity is investing adequately in the maintenance of its operating capacity. An entity that does not invest adequately in the maintenance of its operating capacity may be prejudicing future profitability for the sake of current liquidity and distributions to owners.

52 The disclosure of segmental cash flows enables users to obtain a better understanding of the relationship between the cash flows of the business as a whole and those of its component parts and the availability and variability of segmental cash flows.

Appendix A

Illustrative Examples

Statement of cash flows for an entity other than a financial institution

This appendix accompanies, but is not part of, Ind AS *7.*

1 The examples show only current period amounts. Corresponding amounts for the preceding period are required to be presented in accordance with Ind AS 1 *Presentation of Financial Statements*.

2 Information from the statement of profit and loss and balance sheet is provided to show how the statements of cash flows under the direct method and indirect method have been derived. Neither the statement of profit and loss nor the balance sheet is presented in conformity with the disclosure and presentation requirements of other Standards.

3 The following additional information is also relevant for the preparation of the statements of cash flows:

- all of the shares of a subsidiary were acquired for 590. The fair values of assets acquired and liabilities assumed were as follows:

Inventories	100
Accounts receivable	100
Cash	40
Property, plant and equipment	650
Trade payables	100
Long-term debt	200

- 250 was raised from the issue of share capital and a further 150 was raised from long-term borrowings and 100 was raised from short-term borrowing.

- interest expense was 400, of which 170 was paid during the period. Also, 100 relating to interest expense of the prior period was paid during the period.
- dividends paid were 1,200.
- the liability for tax at the beginning and end of the period was 1,000 and 400 respectively. During the period, a further 200 tax was provided for. Withholding tax on dividends received amounted to 100.
- during the period, the group acquired property, plant and equipment with an aggregate cost of 1,250 of which 900 was acquired by means of finance leases. Cash payments of 350 were made to purchase property, plant and equipment.
- plant with original cost of 80 and accumulated depreciation of 60 was sold for 20.
- accounts receivable as at the end of 20X2 include 100 of interest receivable.

Consolidated statement of profit and loss for the period ended 20X2[(a)]

Sales	30,650
Cost of sales	(26,000)
Gross profit	4,650
Depreciation	(450)
Administrative and selling expenses	(910)
Interest expense	(400)
Investment income	500
Foreign exchange loss	(40)
Profit before taxation	3,350
Taxes on income	(300)
Profit	3,050

[(a)] The entity did not recognise any components of other comprehensive income in the period ended 20X2

Consolidated balance sheet as at end of 20X2

		20X2		20X1
Assets				
Cash and cash equivalents		230		160
Accounts receivable		1,900		1,200
Inventory		1,000		1,950
Portfolio investments		2,500		2,500
Property, plant and equipment at cost	3,730		1,910	
Accumulated depreciation	(1,450)		(1,060)	
Property, plant and equipment net		2,280		850
Total assets		7,910		6,660
Liabilities				
Trade payables		250		1,890
Interest payable		230		100
Income taxes payable		400		1,000
Long-term debt		2,200		1,040
Short-term borrowing		100		_
Total liabilities		3,180		4,030
Shareholders' equity				
Share capital		1,500		1,250
Retained earnings		3,230		1,380
Total shareholders' equity		4,730		2,630
Total liabilities and shareholders' equity		7,910		6,660

Direct method statement of cash flows (paragraph 18(a))

		20X2
Cash flows from operating activities		
Cash receipts from customers	30,150	
Cash paid to suppliers and employees	(27,600)	
Cash generated from operations	2,550	
Income taxes paid	(900)	
Net cash from operating activities		1,650
Cash flows from investing activities		
Acquisition of subsidiary X, net of cash acquired (Note A)	(550)	
Purchase of property, plant and equipment (Note B)	(350)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividends received	200	
Net cash used in investing activities		(480)
Cash flows from financing activities		
Proceeds from issue of share capital	250	
Proceeds from long-term borrowings	150	
Proceeds from short-term borrowings	100	
Payment of finance lease liabilities	(90)	
Interest paid	(270)	
Dividends paid	(1,200)	
Net cash used in financing activities		(1,060)
Net increase in cash and cash equivalents		110
Cash and cash equivalents at beginning of period (Note C)		120
Cash and cash equivalents at end of period (Note C)		230

Indirect method statement of cash flows (paragraph 18(b))

		20X2
Cash flows from operating activities		
Profit before taxation	3,350	
Adjustments for:		
Depreciation	450	
Foreign exchange loss	40	
Investment income	(500)	
Interest expense	400	
	3,740	
Increase in trade and other receivables	(500)	
Decrease in inventories	1,050	
Decrease in trade payables	(1,740)	
Cash generated from operations	2,550	
Income taxes paid	(900)	
Net cash from operating activities		1,650
Cash flows from investing activities		
Acquisition of subsidiary X net of cash acquired (Note A)	(550)	
Purchase of property, plant and equipment (Note B)	(350)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividends received	200	
Net cash used in investing activities		(480)
Cash flows from financing activities		
Proceeds from issue of share capital	250	
Proceeds from long-term borrowings	150	
Proceeds from short-term borrowings	100	
Payment of finance lease liabilities	(90)	
Interest paid	(270)	
Dividends paid	(1,200)	
Net cash used in financing activities		(1,060)

Net increase in cash and cash equivalents	110
Cash and cash equivalents at beginning of period (Note C)	120
Cash and cash equivalents at end of period (Note C)	230

Notes to the statement of cash flows (direct method and indirect method)

A. Obtaining control of subsidiary

During the period the Group obtained control of subsidiary X. The fair values of assets acquired and liabilities assumed were as follows:

Cash	40
Inventories	100
Accounts receivable	100
Property, plant and equipment	650
Trade payables	(100)
Long-term debt	(200)
Total purchase price paid in cash	590
Less: Cash of subsidiary X acquired	(40)
Cash paid to obtain control net of cash acquired	550

B. Property, plant and equipment

During the period, the Group acquired property, plant and equipment with an aggregate cost of 1,250 of which 900 was acquired by means of finance leases. Cash payments of 350 were made to purchase property, plant and equipment.

C. Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and balances with banks, and investments in money market instruments. Cash and cash

equivalents included in the statement of cash flows comprise the following amounts in the balance sheet:

	20X2	**20X1**
Cash on hand and balances with banks	40	25
Short-term investments	190	135
Cash and cash equivalents as previously reported	230	160
Effect of exchange rate changes	–	(40)
Cash and cash equivalents as restated	230	120

Cash and cash equivalents at the end of the period include deposits with banks of 100 held by a subsidiary which are not freely remissible to the holding company because of currency exchange restrictions.

The Group has undrawn borrowing facilities of 2,000 of which 700 may be used only for future expansion.

D. Segment information

	Segment A	Segment B	Total
Cash flows from:			
Operating activities	1,790	(140)	1,650
Investing activities	(640)	160	(480)
Financing activities	(840)	(220)	(1,060)
	310	(200)	110

Alternative presentation (indirect method)

As an alternative, in an indirect method statement of cash flows, operating profit before working capital changes is sometimes presented as follows:

Revenues excluding investment income	30,650	
Operating expense excluding depreciation	(26,910)	
Operating profit before working capital changes		3,740

Appendix B

Illustrative Examples

Statement of cash flows for a financial institution

This appendix accompanies, but is not part of Ind AS 7.

1 The example shows only current period amounts. Comparative amounts for the preceding period are required to be presented in accordance with Ind AS 1 *Presentation of Financial Statements*.

2 The example is presented using the direct method.

		20X2
Cash flows from operating activities		
Interest and commission receipts	28,447	
Interest payments	(23,463)	
Recoveries on loans previously written off	237	
Cash payments to employees and suppliers	(997)	
	4,224	
(Increase) decrease in operating assets:		
Short-term funds	(650)	
Deposits held for regulatory or monetary control purposes	234	
Funds advanced to customers	(288)	
Net increase in credit card receivables	(360)	
Other short-term negotiable securities	(120)	
Increase (decrease) in operating liabilities:		
Deposits from customers	600	
Negotiable certificates of deposit	(200)	
Net cash from operating activities before income tax	3,440	
Income taxes paid	(100)	
Net cash from operating activities		3,340

Cash flows from investing activities		
Disposal of subsidiary Y	50	
Dividends received	200	
Interest received	300	
Proceeds from sales of non-dealing securities	1,200	
Purchase of non-dealing securities	(600)	
Purchase of property, plant and equipment	(500)	
Net cash from investing activities		650
Cash flows from financing activities		
Issue of loan capital	1,000	
Issue of preference shares by subsidiary undertaking	800	
Repayment of long-term borrowings	(200)	
Net decrease in other borrowings	(1,000)	
Dividends paid	(400)	
Net cash from financing activities		200
Effects of exchange rate changes on cash and cash equivalents		600
Net increase in cash and cash equivalents		4,790
Cash and cash equivalents at beginning of period		4,050
Cash and cash equivalents at end of period		8,840

Appendix 1

Note: This Appendix is not a part of the Indian Accounting Standard. The purpose of this Appendix is only to bring out the differences, if any, between Indian Accounting Standard (Ind AS) 7 and the corresponding International Accounting Standard (IAS) 7, Statement of Cash Flows.

Comparison with IAS 7, *Statement of Cash Flows*

Ind AS 7 differs from International Accounting Standard (IAS) 7, *Statement of Cash Flows*, in the following major respects:

1 In case of other than financial entities, IAS 7 gives an option to classify the interest paid and interest and dividends received as item of operating cash flows. Ind AS 7 does not provide such an option and requires these item to be classified as item of financing activity and investing activity, respectively (refer to the paragraph 33).

2 IAS 7 gives an option to classify the dividend paid as an item of operating activity. However, Ind AS 7 requires it to be classified as a part of financing activity only.

3 Different terminology is used in this standard, e.g., the term 'balance sheet' is used instead of 'Statement of financial position' and 'Statement of profit and loss' is used instead of 'Statement of comprehensive income'.

4 Paragraph 2 of IAS 7 which states that IAS 7 supersedes the earlier version IAS 7 is deleted in Ind AS 7 as this is not relevant in Ind AS 7. However, paragraph number 2 is retained in Ind AS 7 to maintain consistency with paragraph numbers of IAS 7.

5 The following paragraph numbers appear as 'Deleted' in IAS 7. In order to maintain consistency with paragraph numbers of IAS 7, the paragraph numbers are retained in Ind AS 7:

(i) paragraph 29

(ii) paragraph 30

Appendix II

Note: This Appendix contains major differences between Ind AS 7, Statement of Cash Flows, as included in this Educational Material and existing AS 3, Cash Flow Statements.

Differences between Ind AS 7, *Statement of Cash Flows and AS 3, Cash Flow Statements*

1. Ind AS 7 specifically includes bank overdrafts which are repayable on demand as a part of cash and cash equivalents, whereas the existing AS 3 is silent on this aspect (refer paragraph 8 of Ind AS 7).

2. Ind AS 7 provides the treatment of cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale in the ordinary course of business as cash flows from operating activities. Further, treatment of cash receipts from rent and subsequent sale of such assets as cash flow from operating activity is also provided (refer paragraph 14 of Ind AS 7). The existing AS 3 does not contain such requirements.

3. Ind AS 7 includes the following new examples of cash flows arising from financing activities (refer paragraph 17 of Ind AS 7):

   (a) cash payments to owners to acquire or redeem the entity's shares;

   (b) cash proceeds from mortgages;

   (c) cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

4. As compared to the existing AS 3, Ind AS 7 specifically requires adjustment of the profit or loss for the effects of 'undistributed profits of associates and non-controlling interests' while determining the net cash flow from operating activities using the indirect method (refer paragraph 20(b) of the Ind AS 7).

5. The existing AS 3 requires cash flows associated with extraordinary activities to be separately classified as arising from operating, investing and financing activities, whereas Ind AS 7 does not contain this requirement.

6. As compared to the existing AS 3, Ind AS 7 requires to disclose the amount of cash and cash equivalents and other assets and liabilities in the subsidiaries or other businesses over which control is obtained or lost (refer paragraph 40(c) and (d) of Ind AS 7). Ind AS 7 also requires to report the aggregate amount of the cash paid or received as consideration for obtaining or losing control of subsidiaries or other businesses in the statement of cash flows, net of cash and cash equivalents acquired or disposed of as a part of such transactions, events or changes in circumstances (refer paragraph 42 of Ind AS 7). The existing AS 3 does not contain such requirements.

7. Ind AS 7 requires to classify cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control as cash flows from financing activities (refer paragraphs 42A and 42B of Ind AS 7). The existing AS 3 does not contain such a requirement.

8. Ind AS 7 mentions the use of Equity or Cost method while accounting for an investment in an associate, a joint venture or a subsidiary (refer paragraphs 37 and 38 of Ind AS 7). The existing AS 3 does not contain such requirements.

9. Ind AS 7 uses the term ‘functional currency’ instead of ‘reporting currency’ (as used in the existing AS 3). Ind AS 7 also deals with translation of cash flows of a foreign subsidiary (refer paragraphs 25 to 27 of Ind AS 7) whereas in the existing AS 3, it is not dealt with.

10. Ind AS 7 requires more disclosures as compared to the existing AS 3 (refer paragraph 50 of the Ind AS 7).