2

Financial Statements of Companies

Unit – 1: Preparation of Financial Statements

Learning Objectives

After studying this unit, you will be able to:

- Know how to maintain books of account of a company.
- Learn about statutory books of a company.
- Prepare and present the financial statements of a company as per Schedule III to the Companies Act, 2013 (Earlier Schedule VI to the Companies Act, 1956).
- Calculate managerial remuneration of managers in a company.
- Appreciate the term divisible profits and dividends.

1.1 Meaning of Company

As per Section 2(20) of the Companies Act, 2013, "Company" means a company incorporated under the Companies Act, 2013 or under any previous company law (e.g., the Companies Act, 1956). Different types of companies have been defined (under various sub-sections of the Companies Act, 2013) as follows:

2(21) "**company limited by guarantee**" means a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up;

2(22) "**Company limited by shares**" means a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them;

2(42) **"Foreign company"** means any company or body corporate incorporated outside India which –

(a) has a place of business in India whether by itself or through an agent physically or through electronic mode; and

(b) conducts any business activity in India in any other manner.

2(45) "**Government company**" means any company in which not less than 51% of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company;

2(62) "**One Person Company**" means a company which has only one person as a member;

2(68) "**Private company**" means a company having a minimum paid-up share capital as may be prescribed, and which by its articles,—

(i) restricts the right to transfer its shares;

(ii) except in case of One Person Company, limits the number of its members to two hundred:

Provided that where two or more persons hold one or more shares in a company jointly, they should, for the purposes of this sub-clause, be treated as a single member:

Provided further that—

(A) persons who are in the employment of the company; and

(B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, should not be included in the number of members; and

(iii) prohibits any invitation to the public to subscribe for any securities of the company;

2(71) **"Public Company"** mans a company which—

(a) is not a private company;

(b) has a minimum paid-up share capital as may be prescribed:

Provided that a company which is a subsidiary of a company, not being a private company, should be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles;

2(85) "**Small company**" means a company, other than a public company, -

(i) paid-up share capital of which does not exceed Rs. 50 lakhs or such higher amount as may be prescribed which should not be more than Rs. 5 crores; or

(ii) turnover of which as per its last profit and loss account does not exceed Rs. 2 crores or such higher amount as may be prescribed which should not be more than Rs. 20 crores:

Provided that nothing in this clause should apply to:

(A) a holding company or a subsidiary company

(B) a company registered under section 8

(C) a company or body corporate governed by any special Act

2(92) "**Unlimited company**" means a company not having any limit on the liability of its members;

2(46) "**Holding company**", in relation to one or more other companies, means a company of which such companies are subsidiary companies;

2(87) "**Subsidiary company**", or "subsidiary", in relation to any other company (that is to say the holding company), means a company in which the holding company-

(i) controls the composition of the Board of Directors; or

(ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed should not have layers of subsidiaries beyond such numbers as may be prescribed.

Explanation – For the purposes of this clause, -

(a) a company should be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

(b) the composition of a company's Board of Directors should be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;

(c) the expression "company" includes any body corporate;

(d) "layer" in relation to a holding company means its subsidiary or subsidiaries;

1.2 Maintenance of Books of Account

As per Section 128 of the Companies Act, 2013, Every company should prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books should be kept on accrual basis and according to the double entry system of accounting:

Provided further that the company may keep such books of account or other relevant papers in electronic mode in such manner as may be prescribed.

Maintenance at Place other than Registered Office

It is a duty of the company to inform the Registrar of Companies within seven days of the decision in case the Board of Directors decides to maintain books at the place other than the registered office.

In Case of Branch Office

Where a company has a branch office in India or outside India, it should be deemed to have complied with the provisions of the Act, if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarised returns periodically are sent by the branch office to the company at its registered office or such other place as the Board of Directors has decided.

Section 128 (3) further lays down that the books of account and other books and papers maintained by the company within India should be open for inspection at the registered office of the company or at such other place in India by any director during business hours, and in the case of financial information, if any, maintained outside the country, copies of such financial information should be maintained and produced for inspection by any director subject to such conditions as may be prescribed. Section 128(5) further states that the books of account of every company relating to a period of not less than 8 financial years immediately preceding a financial year, or where the company had been in existence for a period less than 8 years, in respect of all the preceding years together with the vouchers relevant to any entry in such books of account should be kept in good order.

1.3 Statutory Books

The following statutory books are required to be maintained by a company under different sections of the Companies Act, 2013:

- Register of Investments of the company held in its own name (Section 187)
- Register of Charges (Section 85)
- Register of Members (Sections 88)
- Register of Debenture-holders and other Security holders (Section 88)
- Minute Books (Section 118)
- Register of Contracts, or arrangements in which directors are interested (Section 189)
- Register of directors and key managerial personnels and their shareholding (Section 170)
- Register of Loans and Investments by Company (Section 186)

  In addition, a company usually maintains a number of statistical books to keep a record of its transactions which have resulted either in the payment of money to it or constitute the basis on which certain payments have been made by it.

- Registers and documents relating to the issue of shares are:
  - (i) Share Application and Allotment Book
  - (ii) Share Call Book
  - (iii) Certificate Book
  - (iv) Register of Members
  - (v) Share Transfer Book
  - (vi) Dividend Register

1.4 Annual Return

In accordance with Section 92 of the Companies Act, 2013, every company should prepare an annual return in the form prescribed by the Companies Act, 2013 signed by a director and the company secretary, or where there is no company secretary, by a company secretary in practice:

Provided that in relation to One Person Company and small company, the annual return should be signed by the company secretary, or where there is no company secretary, by the director of the company.

The annual return should be filed with the Registrar within 60 days from the day on which each of the annual general meeting (AGM) is held or where no AGM is held in any year, within 60 days from the date on which AGM should have been held along with a statement showing the reasons why AGM was not held.

1.5 Final Accounts

Under Section 129 of the Companies Act, 2013, at the annual general meeting of a company, the Board of Directors of the company should lay financial statements before the company:

Financial Statements as per Section 2(40) of the Companies Act, 2013, *inter-alia* include -

(i) a balance sheet as at the end of the financial year;

(ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;

(iii) cash flow statement for the financial year;

(iv) a statement of changes in equity, if applicable; and

(v) any explanatory note annexed to, or forming part of, any document referred to in (i) to (iv) above:

Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement.

Requisites of Financial Statements

It should give a true and fair view of the state of affairs of the company as at the end of the financial year.

Provisions Applicable

(1) Specific Act is Applicable

For instance, any

(a) insurance company

(b) banking company or

(c) any company engaged in generation or supply of electricity* or

(d) any other class of company for which a Form of balance sheet or Profit and loss account has been prescribed under the Act governing such class of company

(2) In case of all other companies

Balance Sheet as per Form set out in Part I of Schedule III and Statement of Profit and Loss as per Part II of Schedule III

Points to be kept in mind while preparing final accounts:

- Requirements of Schedule III to the Companies Act;
- Other statutory requirements;
- Accounting Standards notified by Ministry of Corporate Affairs (MCA) (AS 1 to AS 29[1]);
- Statements and Guidance Notes issued by the Institute of Chartered Accountants of India (ICAI); which are necessary for understanding the accounting treatment/ valuation/ disclosure suggested by the ICAI.

Compliance with Accounting Standards

As per section 133 of the Companies Act, it is mandatory to comply with accounting standards notified by the Central Government from time to time.

Schedule III of the Companies Act, 2013

As per section 129 of the Companies Act, 2013, Financial statements should give a true and fair view of the state of affairs of the company or companies and comply with the accounting standards notified under section133 and should be in the form or forms as may be provided for

---

*****_The Electricity Act, 2003 does not specify any format for presentation of Financial Statements. Therefore, Schedule III of the Companies Act, 2013 is followed by Electricity Companies in preparation of their financial statements._

[1] AS 6 and AS 8 have been withdrawn

different class or classes of companies in Schedule III under the Act. Schedule III to the Companies Act, 2013 has been given as Appendix I at the end of this chapter.

Example 1

In the financial statements of the financial year 20X1-20X2, Alpha Ltd. has mentioned in the notes to accounts that during financial year, 24,000 equity shares of ₹ 10 each were issued as fully paid bonus shares. However, the source from which these bonus shares were issued has not been disclosed. Is such non-disclosure a violation of the Schedule III to the Companies Act? Comment.

Solution

Schedule III has come into force for the Balance Sheet and Profit and Loss Account prepared for the financial year commencing on or after 1st April, 20X1. As per Part I of the Schedule III, a company should, inter alia, disclose in notes to accounts for the period of 5 years immediately preceding the balance sheet date (31st March, 20X2 in the instant case) the aggregate number and class of shares allotted as fully paid-up bonus shares. Schedule III does not require a company to disclose the source from which bonus shares have been issued. Therefore, non-disclosure of source from which bonus shares have been issued does not violate the Schedule III to the Companies Act.

Example 2

The management of Loyal Ltd. contends that the work in process is not valued since it is difficult to ascertain the same in view of the multiple processes involved. They opine that the value of opening and closing work in process would be more or less the same. Accordingly, the management had not separately disclosed work in process in its financial statements. Comment in line with Schedule III.

Solution

Schedule III to the companies Act does not require that the amounts of WIP at the beginning and at the end of the accounting period to be be disclosed in the statement of profit and loss. Only changes in inventories of WIP need to be disclosed in the statement of profit and loss. Non-disclosure of such change in the statement of profit and loss by the company may not amount to violation of Schedule III if the differences between opening and closing WIP are not material.

Example 3

Futura Ltd. had the following items under the head "Reserves and Surplus" in the Balance Sheet as on 31st March, 20X1:

	Amount ₹ in lakhs
Securities Premium Account	80
Capital Reserve	60
General Reserve	90

The company had an accumulated loss of ₹ 250 lakhs on the same date, which it has disclosed under the head "Statement of Profit and Loss" as asset in its Balance Sheet. Comment on accuracy of this treatment in line with Schedule III to the Companies Act, 2013.

Solution

Part I of Schedule III to the Companies Act, 2013 provides that debit balance of Statement of Profit and Loss (after all allocations and appropriations) should be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, should be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative. In this case, the debit balance of profit and loss i.e. ₹ 250 lakhs exceeds the total of all the reserves i.e. ₹ 230 lakhs. Therefore, balance of 'Reserves and Surplus' after adjusting debit balance of profit and loss is negative by ₹ 20 lakhs, which should be disclosed on the face of the balance sheet. Thus the treatment done by the company is incorrect.

Example 4

Sumedha Ltd. took a loan from bank for ₹ 10,00,000 to be settled within 5 years in 10 equal half yearly instalments with interest. First instalment is due on 30.09.20X1 of ₹ 1,00,000. Determine how the loan will be classified in preparation of Financial Statements of Sumedha Ltd. for the year ended 31st March, 20X1 according to Schedule III.

Solution

As per Schedule III, a liability should be classified as current when it satisfies any of the following criteria:

(i) it is expected to be settled in the company's normal operating cycle;

(ii) it is held primarily for the purpose of being traded;

(iii) it is due to be settled within twelve months after the reporting date; or

(iv) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

In the given case, instalments due on 30.09.20X1 and 31.03.20X2 will be shown under the head 'other current liabilities' as per criteria (c).

Therefore, in the balance sheet as on 31.3.20X1, ₹ 8,00,000 (₹ 1,00,000 x 8 instalments) will be shown under the heading 'Long term Borrowings' and ₹ 2,00,000 (₹ 1,00,000 x 2 instalments) will be shown under the heading 'Other Current Liabilities' as current maturities of loan from bank.

Note: Students may note that the questions based on preparation of Statement of Profit and Loss and Balance Sheet and explanatory notes as per Schedule III have been given in this Unit. However, questions requiring preparation of cash Flow statements have been separately given in the next unit of this chapter.

1.6 Managerial Remuneration

Managerial remuneration is calculated as a percentage of profit. Managerial remuneration payable by a company is governed by various sections of the Companies Act, 2013 and also Schedule V under the Companies Act, 2013.

The scope of the relevant sections is as below:

Section 197 prescribes the overall maximum managerial remuneration payable and also managerial remuneration in case of absence or inadequacy of profits.

As per Section 197 of the Companies Act, 2013, total managerial remuneration payable by a public company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year should not exceed 11% of the net profits of that company for that financial year computed in the manner laid down in section 198 except that the remuneration of the directors should not be deducted from the gross profits. The company in general meeting may, with the approval of the Central Government, authorise the payment of remuneration exceeding 11% of the net profits of the company, subject to the provisions of Schedule V.

Provided further that, except with the approval of the company in general meeting,—

(i) the remuneration payable to any one managing director; or whole-time directoror manager should not exceed 5% of the net profits of the company and if there are more than one such director, remuneration should not exceed 10% of the net profits to all such directors and manager taken together;

(ii) the remuneration payable to directors who are neither managing directors nor whole-time directors should not exceed,—

   (A) 1% of the net profits of the company, if there is a managing or whole-time director or manager;

   (B) 3% of the net profits in any other case.

Section 198 lays down how the net profit of the company will be ascertained for the purpose of calculating managerial remuneration.

Schedule V consists of four parts. Part I lays down conditions to be fulfilled for the appointment of a managing or whole-time director or a manager without the approval of the Central Government. Part II deals with remuneration payable to managerial person by companies having profits and also by companies having no profits or inadequate profits. Part III specifies the provisions applicable to parts 1 and 2 of this schedule and Part IV deals with Central Government's power to relax any requirements in this Schedule.

The relevant details given under Part II of Schedule V are as follows:

Section I - Remuneration payable by companies having profits:

Subject to the provisions of section 197, a company having profits in a financial year may pay remuneration to a managerial person or persons not exceeding the limits specified in such section.

Section II - Remuneration payable by companies having no profit or inadequate profit without Central Government approval:

Where in any financial year during the currency of tenure of a managerial person, a company has no profits or its profits are inadequate, it may, without Central Government approval, pay remuneration to the managerial person not exceeding the higher of the limits under *(A)* and *(B)* given below:-

(A)

	(1)	*(2)*
	Where the effective capital is*	Limit of yearly remuneration payable should not exceed (Rupees)
(i)	Negative or less than 5 crores	60 Lakhs
(ii)	5 crores and above but less than 100 crores	84 Lakhs
(iii)	100 crores and above but less than 250 crores	120 Lakhs
(iv)	250 crores and above	120 lakhs plus 0.01% of the effective capital in excess of Rs. 250 crores:

Provided that the above limits should be doubled if the resolution passed by the shareholders is a special resolution.

Explanation - It is hereby clarified that for a period less than one year, the limits should be pro-rated.

(B) In case of a managerial person who is functioning in a professional capacity, no approval of Central Government is required, if such managerial person is not having any interest in the capital of the company or its holding company or any of its subsidiaries directly or indirectly or through any other statutory structures and not having any, direct or indirect interest or related to the directors or promoters of the company or its holding company or any of its subsidiaries at any time during the last two years before or on or after the date

**Effective Capital has been explained after Section IV in the succeeding pages of this unit. Students are advised to please refer that definition of Effective Capital.*

of appointment and possesses graduate level qualification with expertise and specialised knowledge in the field in which the company operates:

Provided that any employee of a company holding shares of the company not exceeding 0.5% of its paid up share capital under any scheme formulated for allotment of shares to such employees including Employees Stock Option Plan or by way of qualification should be deemed to be a person not having any interest in the capital of the company;

Provided further that the limits specified under items (A) ant (B) of this section should apply, if-

(i) payment of remuneration is approved by a resolution passed by the Board and, in the case of a company covered under Section 178(1) also by the Nomination and Remuneration Committee;

(ii) the company has not committed any default in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of 30 days in the preceding financial year before the date of appointment of such managerial person and in case of a default, the company obtains prior approval from secured creditors for the proposed remuneration and the fact of such prior approval having been obtained is mentioned in the explanatory statement to the notice convening the general meeting;

(iii) an ordinary resolution or a special resolution, as the case may be, has been passed for payment of Remuneration as per the limits laid down in item (A) or a special resolution has been passed for payment of remuneration as per item (B), at the general meeting of the company for a period not exceeding 3 years.

(iv) a statement along with a notice calling the general meeting referred to in clause (iii) is given to the shareholders containing the following information, namely:-

I. General Information:

(1) Nature of industry

(2) Date or expected date of commencement of commercial production.

(3) In case of new companies, expected date of commencement of activities as per project approved by financial institutions appearing in the prospectus

(4) Financial performance based on given indicators

(5) Foreign investments or collaborations, if any.

II. Information about the appointee:

(1) Background details

(2) Past remuneration

(3) Recognition or awards

(4) Job profile and his suitability

(5) Remuneration proposed

(6) Comparative remuneration profile with respect to industry, size of the company, profile of the position and person (in case of expatriates the relevant details would be with respect to the country of his origin)

(7) Pecuniary relationship directly or indirectly with the company, or relationship with the managerial personnel, if any.

III. Other information:

(1) Reasons of loss or inadequate profits

(2) Steps taken or proposed to be taken for improvement

(3) Expected increase in productivity and profits in measurable terms.

IV. Disclosures:

The following disclosures should be mentioned in the Board of Director's report under the heading "Corporate Governance", if any, attached to the financial statement:-

(i) all elements of remuneration package such as salary, benefits, bonuses, stock options, pension, etc., of all the directors;

(ii) details of fixed component and performance linked incentives along with the performance criteria;

(iii) service contracts, notice period, severance fees;

(iv) stock option details, if any, and whether the same has been issued at a discount as well as the period over which accrued and over which exercisable.

Section III - Remuneration payable by companies having no profit or inadequate profit without Central Government approval in certain special circumstances

In the following circumstances a company may, without the Central Government approval, pay remuneration to a managerial person in excess of the amounts provided in Section II above:-

(a) where the remuneration in excess of the limits specified in Section I or II is paid by any other company and that other company is either a foreign company or has got the approval of its shareholders in general meeting to make such payment, and treats this amount as managerial remuneration for the purpose of Section 197 and the total managerial remuneration payable by such other company to its managerial persons including such amount or amounts is within permissible limits under Section 197.

(b) where the company-

(i) is a newly incorporated company, for a period of seven years from the date of its incorporation, or

(ii) is a sick company, for whom a scheme of revival or rehabilitation has been ordered by the Board for Industrial and Financial Reconstruction for a period of 5 years from the date of sanction of scheme of revival,

(iii) is a company in relation to which a resolution plan has been approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code, 2016 for a period of 5 years from the date of such approval, it may pay remuneration up to two times the amount permissible under Section II.

(c) where remuneration of a managerial person exceeds the limits in Section II but the remuneration has been fixed by the Board for Industrial and Financial Reconstruction or the National Company Law Tribunal:

Provided that the limits under this Section should be applicable subject to meeting all the conditions specified under Section II and the following additional conditions:-

(i) except as provided in para (a) of this Section, the managerial person is not receiving remuneration from any other company;

(ii) the auditor or Company Secretary of the company or where the company has not appointed a Secretary, a Secretary in whole-time practice, certifies that all secured creditors and term lenders have stated in writing that they have no objection for the appointment of the managerial person as well as the quantum of remuneration and such certificate is filed along with the return as prescribed under sub-section (4) of section 196.

(iii) the auditor or Company Secretary or where the company has not appointed a secretary, a secretary in whole-time practice certifies that there, is no default on payments to any creditors, and all dues to deposit holders are being settled on time.

(d) a company in a Special Economic Zone as notified by Department of Commerce from time to time which has not raised any money by public issue of shares or debentures in India, and has not made any default in India in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in any financial year, may pay remuneration up to ₹2,40,00,000 per annum.

Section IV -Perquisites not included in managerial remuneration:

1. A managerial person should be eligible for the following perquisites which should not be included in the computation of the ceiling on remuneration specified in Section II and Section III:-

(a) contribution to provident fund, superannuation fund or annuity fund to the extent these either singly or put together are not taxable under the Income-tax Act, 1961;

(b) gratuity payable at a rate not exceeding half a month's salary for each completed year of service; and

(c) encashment of/eave at the end of the tenure.

2. In addition to the perquisites specified in paragraph 1 of this section, an expatriate managerial person (including a non-resident Indian) should be eligible to the following perquisites which should not be included in the computation of the ceiling on remuneration specified in Section II or Section III-

(a) Children's education allowance: In case of children studying in or outside India, an allowance limited to a maximum of ₹12,000 per month per child or actual expenses incurred, whichever is less. Such allowance is admissible up to a maximum of two children.

(b) Holiday passage for children studying outside India or family staying abroad: Return holiday passage once in a year by economy class or once in two years by first class to children and to the members 'of the family from the place of their study or stay abroad to India if they are not residing in India, with the managerial person.

(c) Leave travel concession: Return passage for self and family in accordance with the rules specified by the company where it is proposed that the leave be spent in home country instead of anywhere in India.

Explanation I- For the purposes of Section II of this Part, "**Effective capital"** means the aggregate of the paid-up share capital (excluding share application money or advances against shares); amount, if any, for the time being standing to the credit of share premium account; reserves and surplus (excluding revaluation reserve); long-term loans and deposits repayable after one year (excluding working capital loans, over drafts, interest due on loans unless funded, bank guarantee, etc., and other short-term arrangements) as reduced by the aggregate of any investments (except in case of investment by an investment company whose principal business is acquisition of shares, stock, debentures or other securities), accumulated losses and preliminary expenses not written off.

Explanation II-(a) Where the appointment of the managerial person is made in the year in which company has been incorporated, the effective capital should be calculated as on the date of such appointment;

(b) In any other case the effective capital should be calculated as on the last date of the financial year preceding the financial year in which the appointment of the managerial person is made.

Explanation III - For the purposes of this Schedule, "family" means the spouse, dependent children and dependent parents of the managerial person.

Explanation IV-The Nomination and Remuneration Committee while approving the remuneration under Section II or Section III, should-

(a) take into account, financial position of the company, trend in the industry, appointee's qualification, experience, past performance, past remuneration, etc.;

(b) be in a position to bring about objectivity in determining the remuneration package while striking a balance between the interest of the company and the shareholders.

Explanation V–For the purposes of this Schedule, "negative effective capital" means the effective capital which is calculated in accordance with the provisions contained in Explanation I of this Part is less than zero.

Explanation VI -For the purposes of this Schedule:-

(A) "current relevant profit" means the profit as calculated under section 198 but without deducting the excess of expenditure over income referred to in sub-section 4 (I) thereof in respect of those years during which the managerial person was not an employee, director or shareholder of the company or its holding or subsidiary companies.

(B) "Remuneration" means remuneration as defined in clause 78 of section 2 and includes reimbursement of any direct taxes to the managerial person.

Section V - Remuneration payable to a managerial person in two companies:

Subject to the provisions of sections I to IV, a managerial person should draw remuneration from one or both companies, provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from anyone of the companies of which he is a managerial person.

Note: The appointment and remuneration referred to in Part I and Part II of this Schedule should be subject to approval by a resolution of the shareholders in general meeting.

Ascertainment of profit for managerial remuneration

As we have seen above that in case of a company having profits, managerial remuneration is calculated as a percentage on net profit. Such net profit is to be arrived in accordance with the provisions of Section 198 of the Companies Act, 2013.

As per Section 198 of the Companies Act, 2013,

(I) In making the computation aforesaid, credit should be given for the bounties and subsidies received from any Government, or any public authority constituted or authorised in this behalf, by any Government, unless and except in so far as the Central Government otherwise directs.

(II) In making the computation of the net profits, credit should not be given for the following sums, namely:—

(a) profits, by way of premium on shares or debentures of the company, which are issued or sold by the company

(b) profits on sales by the company of forfeited shares

(c) profits of a capital nature including profits from the sale of the undertaking or any of the undertakings of the company or of any part thereof

(d) profits from the sale of any immovable property or fixed assets of a capital nature comprised in the undertaking or any of the undertakings of the company, unless the business of the company consists, whether wholly or partly, of buying and selling any such property or assets: Provided that where the amount for which any fixed asset is sold exceeds the written-down value thereof, credit should be given for so much of the excess as is not higher than the difference between the original cost of that fixed asset and its written-down value

(e) any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value

(III) In making the computation aforesaid, the following sums should be deducted, namely:—

(a) all the usual working charges

(b) directors' remuneration

(c) bonus or commission paid or payable to any member of the company's staff, or to any engineer, technician or person employed or engaged by the company, whether on a whole-time or on a part-time basis

(d) any tax notified by the Central Government as being in the nature of a tax on excess or abnormal profits

(e) any tax on business profits imposed for special reasons or in special circumstances and notified by the Central Government in this behalf

(f) interest on debentures issued by the company

(g) interest on mortgages executed by the company and on loans and advances secured by a charge on its fixed or floating assets

(h) interest on unsecured loans and advances

(i) expenses on repairs, whether to immovable or to movable property, provided the repairs are not of a capital nature

(j) outgoings inclusive of contributions made under section 181 of the Act

(k) depreciation to the extent specified in section 123 of the Act

(l) the excess of expenditure over income, which had arisen in computing the net profits in accordance with this section in any year which begins at or after the commencement of this Act, in so far as such excess has not been deducted in any subsequent year preceding the year in respect of which the net profits have to be ascertained

(m) any compensation or damages to be paid in virtue of any legal liability including a liability arising from a breach of contract

(n) any sum paid by way of insurance against the risk of meeting any liability such as is referred to in clause (m)

(o) debts considered bad and written off or adjusted during the year of account

(IV) In making the computation aforesaid, the following sums should not be deducted, namely:—

(a) income-tax and super-tax payable by the company under the Income-tax Act, 1961, or any other tax on the income of the company not falling under clauses (d) and (e) of sub-section (4)

(b) any compensation, damages or payments made voluntarily, that is to say, otherwise than in virtue of a liability such as is referred to in clause (m) of sub-section (4)

(c) loss of a capital nature including loss on sale of the undertaking or any of the undertakings of the company or of any part thereof not including any excess of the written-down value of any asset which is sold, discarded, demolished or destroyed over its sale proceeds or its scrap value

(d) any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value

Illustration 1

The following is the Draft Profit & Loss A/c of Mudra Ltd., the year ended 31st March, 20X1:

	₹		₹
To Administrative, Selling and distribution expenses	*8,22,542*	*By Balance b/d*	*5,72,350*
		" Balance from Trading A/c	*40,25,365*
		" Subsidies received from Govt.	*2,73,925*
" Directors fees	*1,34,780*		
" Interest on debentures	*31,240*		
" Managerial remuneration	*2,85,350*		
" Depreciation on fixed assets	*5,22,543*		
" Provision for Taxation	*12,42,500*		
" General Reserve	*4,00,000*		
" Investment Revaluation Reserve	*12,500*		
" Balance c/d	*14,20,185*		
	48,71,640		*48,71,640*

Depreciation on fixed assets as per Schedule II of the Companies Act, 2013 was ₹5,75,345. You are required to calculate the maximum limits of the managerial remuneration as per Companies Act, 2013.

Solution:

Calculation of net profit u/s 198 of the Companies Act, 2013

	₹	₹
Balance from Trading A/c		40,25,365
Add : Subsidies received from Government		2,73,925
		42,99,290
Less : Administrative, selling and distribution expenses	8,22,542	
Director's fees	1,34,780	
Interest on debentures	31,240	
Depreciation on fixed assets as per Schedule II	5,75,345	(15,63,907)
Profit u/s 198		27,35,383

Maximum Managerial remuneration under Companies Act, 2013= 11% of ₹27,35,383= ₹3,00,892

Illustration 2

The following extract of Balance Sheet of X Ltd. was obtained:

Balance Sheet (Extract) as on 31st March, 20X1

Liabilities	₹
Authorised capital:	
20,000, 14% preference shares of ₹100	*20,00,000*
2,00,000 Equity shares of ₹100 each	*2,00,00,000*
	2,20,00,000
Issued and subscribed capital:	
15,000, 14% preference shares of ₹100 each fully paid	*15,00,000*
1,20,000 Equity shares of ₹100 each, ₹80 paid-up	*96,00,000*
Share suspense account	*20,00,000*
Reserves and surplus	
Capital reserves (₹ 1,50,000 is revaluation reserve)	*1,95,000*
Securities premium	*50,000*
Secured loans:	
15% Debentures	*65,00,000*
Unsecured loans:	
Public deposits	*3,70,000*
Cash credit loan from SBI (short term)	*4,65,000*
Current Liabilities:	
Trade Payables	*3,45,000*
Assets:	
Investment in shares, debentures, etc.	*75,00,000*
Profit and Loss account(Dr.balance)	*15,25,000*

Share suspense account represents application money received on shares, the allotment of which is not yet made.

You are required to compute effective capital as per the provisions of Schedule V. Would your answer differ if X Ltd. is an investment company?

Solution

Computation of effective capital :

	Where X Ltd. is a non-investment company	*Where X Ltd. is an investment company*
	₹	₹
Paid-up share capital —		
15,000, 14% Preference shares	15,00,000	15,00,000
1,20,000 Equity shares	96,00,000	96,00,000
Capital reserves (1,95,000 – 1,50,000)	45,000	45,000
Securities premium	50,000	50,000
15% Debentures	65,00,000	65,00,000
Public Deposits	3,70,000	3,70,000
(A)	1,80,65,000	1,80,65,000
Investments	75,00,000	—
Profit and Loss account (Dr. balance)	15,25,000	15,25,000
(B)	90,25,000	15,25,000
Effective capital (A–B)	90,40,000	1,65,40,000

Illustration 3

Kumar Ltd., a non investment company has been incurring losses for the past few years. The company provides the following information for the current year:

	(₹ in lakhs)
Paid up equity share capital	120
Paid up Preference share capital	20
Reserves (including Revaluation reserve ₹ 10 lakhs)	150
Securities premium	40
Long term loans	40
Deposits repayable after one year	20
Application money pending allotment	720
Accumulated losses not written off	20
Investments	180

Kumar Ltd. has only one whole-time director, Mr. X. You are required to calculate the amount of maximum remuneration that can be paid to him as per provisions of Part II of Schedule XIII, if no special resolution is passed at the general meeting of the company in respect of payment of remuneration for a period not exceeding three years.

Solution

Calculation of effective capital and maximum amount of monthly remuneration

	(₹ in lakhs)
Paid up equity share capital	120
Paid up Preference share capital	20
Reserve excluding Revaluation reserve (150- 10)	140
Securities premium	40
Long term loans	40
Deposits repayable after one year	20
	380
Less: Accumulated losses not written off	(20)
Investments	(180)
Effective capital for the purpose of managerial remuneration	180

Since Kumar Ltd. is incurring losses and no special resolution has been passed by the company for payment of remuneration, managerial remuneration will be calculated on the basis of effective capital of the company, therefore maximum remuneration payable to the Managing Director should be @ ₹ 60,00,000 per annum.

Note: Revaluation reserve, and application money pending allotment are not included while computing effective capital of Kumar Ltd.

1.7 Divisible Profit

One of the important functions of company accounting is to determine the amount of profits which is available for distribution to the shareholders as dividend. This is necessary since the amount of profits disclosed by the Profit & Loss Account, in every case, is not available for distribution. The availability of profits for distribution depends on a number of factors, *e.g.*, their composition, the amount of provisions and appropriations that must be made out of them in priority, etc.

Meaning of Dividend

(a) A dividend is a distribution of divisible profit of a company among the members according to the number of shares held by each of them in the capital of the company and the rights attaching thereto.

(b) Such a distribution may or may not entail a release of assets; it would be where a distribution involves payment of cash.

(c) But when profits are capitalised and the amount distributed is applied towards payment of bonus shares, issued free to the shareholders, no part of the assets of the company can be said to have been released since, in such a case, profits are only capitalised, thereby increasing the paid up capital of the company. The company does not give up any asset.

As per Section 2 (35) of the Companies Act, 2013, term "Dividend" includes interim dividend also.

Under Section 123 (1) of the Companies Act, 2013, no dividend should be declared or paid by a company for any financial year except-

(a) Out of the profits of the company for that financial year arrived at after providing for depreciation in accordance with the provisions of section 123(2), or

(b) Out of the profits for any previous financial years arrived at after providing for depreciation in accordance with the provisions of that sub section and remaining undistributed; or

(c) Out of both the above;

(d) Out of the moneys provided by the Central Government or any State Government for the payment of dividend by the Company in pursuance of any guarantee given by that government

Provided that no dividend should be declared or paid by a company from its reserves other than free reserves.

Declaration of a dividend presupposes that there is a trading profit or a surplus available for distribution, arrived at after providing for depreciation on assets, not only for the year in which the profits were earned but also for any arrears of depreciation of the past years, calculated in the manner prescribed by sub-section (2) of Section 123.

Sub-section (3) of Section 124 further states that the Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the profit and loss account and out of profits of the financial year in which such interim dividend is sought to be declared: Provided that in case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend should not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.

Dividends cannot be declared except out of profits.

Capital cannot be returned to the shareholders by way of dividend.

Dividend can be declared and paid by a company only out of the profits or free reserves (other than moneys provided by Central or State Govt.) as the payment of dividend from any other source will amount to payment of dividend from capital units.

Provision for Depreciation

Section 123(2) provides that depreciation must be to the extent specified in Schedule II to the Companies Act, 2013.Further, when the assets are sold, discarded, demolished or destroyed in any financial year, the excess of the written down value over its sale proceeds as scrap, if any should be written off in the same financial year.

Declaration and Payment of Dividend

For the purpose of second proviso to sub-section (1) of section 123, a company may declare dividend out of the accumulated profits earned by it in previous years and transferred by it to the reserves, in the event of inadequacy or absence of profits in any year, subject to the fulfillment of the following conditions as per Companies (Declaration and Payment of Dividend) Rules, 2014

(1) The rate of dividend declared should not exceed the average of the rates at which dividend was declared by it in the three years immediately preceding that year: provided that this sub-rule should not apply to a company, which has not declared any dividend in each of the three preceding financial year.

(2) The total amount to be drawn from such accumulated profits should not exceed one-tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.

(3) The amount so drawn should first be utilised to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.

(4) The balance of reserves after such withdrawal should not fall below 15% of its paid up share capital as appearing in the latest audited financial statement.

(5) No company should declare dividend unless carried over previous losses and depreciation not provided in previous year are set off against profit of the company of the current year the loss or depreciation, whichever is less, in previous years is set off against the profit of the company for the year for which dividend is declared or paid.

Transfer to Reserves

I The Board of Directors are free and can appropriate a part of the profits to the credit of a reserve or reserves as per section 123 (1)of the Companies Act, 2013.

II Appropriation of a part of profit is sometimes made under law.

(a) For example, under the Banking Regulation Act, a fixed percentage of the profit of a banking company must first be transferred to the General Reserve before any dividend can be distributed.

(b) Transfer of a part of profit to a reserve is also necessary where the company has undertaken, at the time of raising of loan, that before any part of its profit is distributed, a specified percentage of the profit every year should be credited to a reserve for the repayment of the loan and until the time for repayment arrives, the amount should remain invested in a specified manner.

III Apart from appropriations aforementioned, it may also be necessary to provide for losses and arrears of depreciation and to exclude capital profit, as mentioned earlier, to arrive at the amount of divisible profit.

Declaration of Dividend

As per Section 123 of the Companies Act, 2013, Board of Directors of a company may declare dividend including interim dividend during any financial year out of the surplus in the profit and loss account and out of profits of the financial year in which such interim dividend is sought to be declared:

Provided that in case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend should not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.

The amount of the dividend, including interim dividend, should be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend.

No dividend should be paid by a company in respect of any share therein except to the registered shareholder of such share or to his order or to his banker and should not be payable except in cash: Provided that nothing in Section 123 should be deemed to prohibit the capitalisation of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company:

Provided further that any dividend payable in cash may be paid by cheque or warrant or in any electronic mode to the shareholder entitled to the payment of the dividend.

Dividend on preference shares

(a) Holders of preference shares are entitled to receive a dividend at a fixed rate before any dividend is declared on equity shares.

(b) But such a right can be exercised subject to there being profits and the Directors recommending payment of the dividend.

Dividend on partly paid shares:

- A company may if so authorised by its Article, pay a dividend in proportion to the amount paid on each share (Section 51 of the Companies Act, 2013).

Calls in Advance

Calls paid in advance do not rank for payment of dividend.

Payment of Dividend

As per Section 124 of the Companies Act, 2013:

(1) Where a dividend has been declared by a company but has not been paid or claimed within thirty days from the date of the declaration to any shareholder entitled to the payment of the dividend, the company should, within seven days from the date of expiry of the said period of thirty days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf in any scheduled bank to be called the Unpaid Dividend Account.

(2) The company should, within a period of ninety days of making any transfer of an amount under this section to the Unpaid Dividend Account, prepare a statement containing the names, their last known addresses and the unpaid dividend to be paid to each person and place it on the website of the company, if any, and also on any other website approved by the Central Government for this purpose, in such form, manner and other particulars as may be prescribed.

(3) If any default is made in transferring the total amount or any part thereof to the Unpaid Dividend Account of the company, it should pay, from the date of such default, interest on so much of the amount as has not been transferred to the said account, at the rate of 12% per annum and the interest accruing on such amount should ensure to the benefit of the members of the company in proportion to the amount remaining unpaid to them.

(4) Any person claiming to be entitled to any money transferred to the Unpaid Dividend Account of the company may apply to the company for payment of the money claimed.

(5) Any money transferred to the Unpaid Dividend Account of a company in pursuance of this section which remains unpaid or unclaimed for a period of seven years from the date of such transfer should be transferred by the company along with interest accrued, if any, thereon to the Fund "Investor Education and Protection Fund" established section 125 and the company should send a statement in the prescribed form of the details of such transfer to the authority which administers the said Fund and that authority should issue a receipt to the company as evidence of such transfer.

(6) All shares in respect of which unpaid or unclaimed dividend has been transferred to "Investor Education and Protection Fund" should also be transferred by the company in the name of Investor Education and Protection Fund along with a statement containing such details as may be prescribed:

Provided that any claimant of shares transferred above should be entitled to claim the transfer of shares from Investor Education and Protection Fund in accordance with such procedure and on submission of such documents as may be prescribed.

(7) If a company fails to comply with any of the requirements of this section, the company will be punishable with fine which will not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default will be punishable with fine which will not be less than one lakh rupees but which may extend to five lakh rupees.

Illustration 4

Due to inadequacy of profits during the year ended 31st March, 20X2, XYZ Ltd. proposes to declare 10% dividend out of general reserves. From the following particulars, ascertain the amount that can be utilised from general reserves, according to the Companies (Declaration of dividend out of Reserves) Rules, 2014:

	₹
17,500 9% Preference shares of ₹ 100 each, fully paid up	17,50,000
8,00,000 Equity shares of ₹ 10 each, fully paid up	80,00,000
General Reserves as on 1.4.20X1	25,00,000
Capital Reserves as on 1.4.20X1	3,00,000
Revaluation Reserves as on 1.4.20X1	3,50,000
Net profit for the year ended 31st March, 20X2	3,00,000

Average rate of dividend during the last five year has been 12%.

Solution

Amount that can be drawn from reserves for 10% dividend

10% dividend on ₹ 80,00,000		₹ 8,00,000
Profits available		
Current year profit	3,00,000	
Less: Preference dividend	(1,57,500)	(1,42,500)
Amount which can be utilised from reserves		6,57,500

Conditions as per Companies (Declaration of dividend out of Reserves) Rules, 20X1:

Condition I

Since 10% is lower than the average rate of dividend (12%), 10% dividend can be declared.

Condition II

Maximum amount that can be drawn from the accumulated profits and reserves should not exceed 10% of paid up capital plus free reserves ie. ₹ 12,25,000 [10% of (80,00,000+17,50,000+25,00,000)]

Condition III

The balance of reserves after drawl ₹18,42,500 (₹ 25,00,000 - ₹ 6,57,500) should not fall below 15 % of its paid up capital ie. ₹ 14,62,500 (15% of ₹ 97,50,000]

Since all the three conditions are satisfied, the company can withdraw ₹ 6,57,500 from accumulated reserves.(as per Declaration and Payment of Dividend Rules, 2014.)

Dividend Distribution Tax

1. Meaning

(a) The Finance Act, 1997, has introduced Chapter XIID (Sections 115O and 115Q) on "Special Provisions Relating to Tax on Distributed profits of Domestic Companies" [Hereinafter referred to as 'DDT' (Dividend Distribution tax)]. The ICAI has also issued Guidance Note on Accounting for Corporate Dividend Tax.

(b) The salient features of DDT are as below:

(i) DDT is in addition to the income-tax chargeable in respect of the total income of a domestic company.

(ii) With effect from 1st Oct, 2014 dividend and income distribution tax is leviable on gross dividend / income and not on the net dividend / income distributed to shareholders and unit holders as per Income- tax Act, 1961.

(iii) The dividends chargeable to DDT may be out of the current profits or accumulated profits.

(iv) The rate of DDT is 15% (excluding surcharge of 12% plus secondary and higher education cess is (2+1) 3%).

(v) DDT should be payable even if no income-tax is payable by the domestic company on its total income.

(vi) DDT is payable to the credit of the Central Government within 14 days of

(a) declaration of any dividend,

(b) distribution of any dividend, or

(c) payment of any dividend.

whichever is the earliest.

(vii) DDT paid should be treated as the final payment of tax on the dividends and no further credit therefore should be claimed by the company or by any person in respect of the tax so paid.

(viii) The expression 'dividend' should have the same meaning as is given to 'dividend' in Section 2 of the Companies Act, 2013.

To make clear the understanding of the concept of grossing for calculation of CDT, an example has been given as follows:

Example

X Ltd., a domestic company, has distributed on 5th April 20X1, dividend of ₹230 lakh to its shareholders. Compute the Dividend Distribution tax payable by X Ltd.

Solution

Calculation of corporate dividend tax

Particulars	₹in lakh
Dividend distributed by X Ltd.	230
Add: Increase for the purpose of grossing up of dividend $\left[\frac{15}{100-15} \times 230\right]$	40.58
Gross dividend	270.59
Dividend distribution tax @ 15% [15% of ₹270.59 lakh]	40.59
Add: Surcharge@12%	4.88
	45.47
Add: Education cess@2% and SHEC@1%	1.36
Dividend Distribution tax	46.83

2. Accounting for DDT

- ***As per AS 4 (Revised), Final dividend declared after the balance sheet date is recognised in the financial year in which it has been approved by the shareholder, i.e., there is no provision for dividend on the balance sheet date (to be disclosed by way of note only).In view of this, DDT on dividend, being directly linked to the amount of the dividend concerned, should also be reflected in the accounts of the same financial year even though the actual tax liability in respect thereof may arise in a different year.***

3. Disclosure and Presentation of DDT in Financial Statements

- ***Dividend on shares is an appropriation of profit which is not shown in the Statement of Profit and Loss as per the Schedule III to the Companies Act, 2013.***

It is shown as an appropriation or allocation of profit in the 'Notes to Accounts' of the 'Reserves and Surplus' item of the Balance sheet.

- ***Since dividends are appropriation to profits which is not the part of disclosure in the Statement of Profit and Loss, therefore, a question arises with regard to disclosure and presentation of DDT, as to whether the said tax should also be disclosed as appropriation or should be disclosed along with the normal income-tax provision for the year.***
- ***The liability in respect of DDT arises only if the profits are distributed as dividends whereas the normal income-tax liability arises on the earning of the taxable profits***
- ***Since the DDT liability relates to distribution of profits as dividends which are disclosed as appropriation /allocation of profit in the 'Notes to Accounts' of 'Reserves and Surplus', it is appropriate that the liability in respect of DDT should also be disclosed therein.***
- ***It is felt that such a disclosure would give a proper picture regarding payments involved with reference to dividends.***
- ***DDT liability should be recognised in the accounts of the same financial year in which the dividend concerned is recognised.***
- ***DDT liability should be disclosed separately in the 'Notes to Accounts' of 'Reserves and Surplus', as follows:***

Dividend	***xxxxx***	
Dividend Distribution tax thereon	***xxxxx***	***xxxxx***

- ***The accounting treatment for Dividend Distribution tax in the financial statements of a company can be explained with the help of following:***

Example

On 31st March, 20X1 X Ltd. declared dividend amounting to ₹ 425 lacs for the year 20XX-20X1. The Dividend Distribution tax liability (15% of Corporate dividend tax including surcharge @ 12%, Education Cess @ 2% and SHEC @ 1% i.e. 17.304%) arises as per Income-tax Act,1961. In this case, calculate the grossing-up of dividend and separately disclosed the charge for DDT in the 'Notes to Accounts' of 'Reserves and Surplus'.

Solution

Calculation of grossing-up of dividend:

Particulars	*₹ in lacs*
Dividend distributed by X CO.	425

Add: Increase for the purpose of grossing up of dividend $\left[\frac{15}{100-15} \times 425\right]$	75
Gross dividend	500
Dividend distribution tax @ 17.304%	86.52

(An Extract)

- 'Notes to Accounts' of 'Reserves and Surplus'
- for the year ended 31st March, 20X1

	₹ *(lacs)*	₹ *(lacs)*
Dividend	425.00	
Dividend Distribution tax	86.52	511.52

The Dividend Distribution tax should be disclosed separately under, the head 'Other Current Liabilities'. The relevant extracts of the Balance Sheet of X Ltd. can be shown as follows:

Balance Sheet as on 31st March, 20X1

'Other Current Liabilities'	₹ (lacs)
Dividend declared	425.000
Declared Distribution tax	86.52

Illustration 5

The following is the Trial Balance of Omega Limited as on 31.3.20X2:

(Figures in ₹000)

	Debit		*Credit*
Land at cost	*220*	*Equity Capital (Shares of ₹10 each)*	*300*
Plant & Machinery at cost	*770*	*10% Debentures*	*200*
Trade Receivables	*96*	*General Reserve*	*130*
Inventories (31.3.X2)	*86*	*Profit & Loss A/c*	*72*
Bank	*20*	*Securities Premium*	*40*
Adjusted Purchases	*320*	*Sales*	*700*
Factory Expenses	*60*	*Trade Payables*	*52*
Administration Expenses	*30*	*Provision for Depreciation*	*172*
Selling Expenses	*30*	*Suspense Account*	*4*
Debenture Interest	*20*		
Interim Dividend Paid	*18*		
	1670		*1670*

Additional Information:

(i) The authorised share capital of the company is 40,000 shares of ₹ 10 each.

(ii) The company on the advice of independent valuer wish to revalue the land at ₹ 3,60,000.

(iii) Declared final dividend @ 10%.

(iv) Suspense account of ₹ 4,000 represents cash received for the sale of some of the machinery on 1.4.20X1. The cost of the machinery was ₹ 10,000 and the accumulated depreciation thereon being ₹ 8,000.

(v) Depreciation is to be provided on plant and machinery at 10% on cost.

You are required to prepare Omega Limited's Balance Sheet as on 31.3.20X2 and Statement of Profit and Loss with notes to accounts for the year ended 31.3.20X2 as per Schedule III. Ignore previous years' figures & taxation.

Solution

Omega Limited
Balance Sheet as at 31st March, 20X2

Particulars	*Note No.*	*(₹in 000)*
Equity and Liabilities		
1. Shareholders' funds		
a Share capital	1	300
b Reserves and Surplus	2	500
2. Non-Current liabilities		
a Long term borrowings	3	200
3. Current liabilities		
a Trade Payables		52
b Other Current Liability	4	30
Total		**1082**
Assets		
1. Non-current assets		
a Fixed assets		
i Tangible assets	5	880
2. Current assets		
a Inventories		86
b Trade receivables		96
c Cash and bank balances		20
Total		**1082**

Omega Limited
Statement of Profit and Loss for the year ended 31st March, 20X2

	Particulars	*Notes*	*(₹ in 000)*
I.	Revenue from operations		700
II.	Other Income	6	2
III	**Total Revenue**		**702**
IV	Expenses:		
	Purchases		320
	Finance costs	7	20
	Depreciation (10% of 760[2])		76
	Other expenses	8	120
	Total Expenses		**536**
V.	**Profit (Loss) for the period** (III – IV)		**166**

Notes to accounts

				(₹ in 000)
1.	**Share Capital**			
	Equity share capital			
	Authorised			
	40,000 shares of ₹ 10 each			400
	Issued & subscribed & called up			
	30,000 shares of ₹ 10 each			300
	Total			**300**
2.	**Reserves and Surplus**			
	Securities Premium Account			40
	Revaluation reserve (360 – 220)			140
	General reserve			130
	Profit & loss Balance			
	Opening balance	72		
	Profit for the period	166	238	
	Less: Appropriations			
	Interim Dividend		(18)	
	Final Dividend (300 x 10%)		(30)	190
				500
3.	**Long term borrowing**			
	10% Debentures			200

[2] 770 (Plant and machinery at cost) – 10 (Cost of plant and machinery sold)

4.	**Other Current Liability**		
	Dividend		30
5.	**Tangible assets**		
	Land		
	Opening balance	220	
	Add: Revaluation adjustment	140	
	Closing balance		360
	Plant and Machinery		
	Opening balance	770	
	Less: Disposed off	(10)	
		760	
	Less: Depreciation (172-8+76)	(240)	
	Closing balance		520
	Total		880
6.	**Other Income**		
	Profit on sale of machinery:		
	Sale value of machinery	4	
	Less: Book value of machinery (10-8)	(2)	2
7.	**Finance costs**		
	Debenture interest		20
8.	**Other expenses:**		
	Factory expenses	60	
	Selling expenses	30	
	Administrative expenses	30	120

Illustration 6

You are required to prepare Balance sheet and statement of Profit and Loss from the following trial balance of Haria Chemicals Ltd. for the year ended 31st March, 20X1.

Haria Chemicals Ltd.
Trial Balance as at 31st March, 20X1

Particulars	*₹*	*Particulars*	*₹*
Inventory	*6,80,000*	*Equity Shares*	
Furniture	*2,00,000*	*Capital (Shares of ₹10 each)*	*25,00,000*
Discount	*40,000*	*11% Debentures*	*5,00,000*
Loan to Directors	*80,000*	*Bank loans*	*6,45,000*
Advertisement	*20,000*	*Trade payables*	*2,81,000*
Bad debts	*35,000*	*Sales*	*42,68,000*
Commission	*1,20,000*	*Rent received*	*46,000*
Purchases	*23,19,000*	*Transfer fees*	*10,000*
Plant and Machinery	*8,60,000*	*Profit & Loss account*	*1,39,000*

Rentals	*25,000*	*Depreciation provision:*	
Current account	*45,000*	*Machinery*	*1,46,000*
Cash	*8,000*		
Interest on bank loans	*1,16,000*	*:*	
Preliminary expenses	*10,000*		
Fixtures	*3,00,000*		
Wages	*9,00,000*		
Consumables	*84,000*		
Freehold land	*15,46,000*		
Tools & Equipments	*2,45,000*		
Goodwill	*2,65,000*		
Trade receivables	*4,40,000*		
Dealer aids	*21,000*		
Transit insurance	*30,000*		
Trade expenses	*37,000*		
Distribution freight	*54,000*		
Debenture interest	*55,000*		
	85,35,000		*85,35,000*

Additional information: Closing Inventory on 31-3-20X1: ₹8,23,000.

Solution

Haria Chemicals Ltd.

Balance Sheet as at 31st March, 20X1

	Schedule No. (1)	*Rupees as at* the *end of*31st March 20X1 *(2)*
Equity and Liabilities		
(1) Shareholders' funds :		
(a) Share Capital	1	25,00,000
(b) Reserves and Surplus	2	7,40,000
(2) Non Current Liabilities		
(a) Long term borrowings	3	11,45,000
(3) Current Liabilities		
(a) Trade payables		2,81,000
Total		**46,66,000**

Assets		
(1) Non current assets		
Fixed Assets:		
(a) Tangible assets	4	30,05,000
(b) Intangible assets (goodwill)		2,65,000
(2) Current assets		
(a) Inventories		8,23,000
(b) Trade receivables		4,40,000
(c) Cash and bank balances	5	53,000
(d) Short term loans and advances	6	80,000
Total		**46,66,000**

Haria Chemicals Ltd.

Statement of Profit and Loss for the year ended 31st March, 20X1

		Schedule	***Figures***	
Revenue from operations			42,68,000	
Other income	(A)	7	56,000	
			43,24,000	
Expenses				
Cost of materials consumed		8	23,19,000	
Change in inventory of finished goods		9	(1,43,000)	
Employee benefit expenses		10	9,00,000	
Finance cost		11	1,71,000	
Other expenses	(B)	12	4,76,000	
			37,23,000	
Profit before tax (A – B)				6,01,000
Provision for tax				—
Profit for the period				6,01,000

Notes to Accounts

1.	**Share capital**	**₹**
	Authorised :	
	Equity share capital of ₹10 each	25,00,000
	Issued and Subscribed :	
	Equity share capital of ₹10 each	25,00,000

2. Reserves and Surplus

Balance as per last balance sheet	1,39,000
Balance in profit and loss account	6,01,000
	7,40,000

3. Long term Borrowings

11% Debentures	5,00,000
Bank loans (assumed long-term)	6,45,000
	11,45,000

4. Tangible Assets

	Gross block	*Depreciation*	*Net Block*
Freehold land	15,46,000		15,46,000
Furniture	2,00,000		2,00,000
Fixtures	3,00,000		3,00,000
Plant & Machinery	8,60,000	1,46,000	7,14,000
Tools & Equipment	2,45,000		2,45,000
Total	31,51,000	1,46,000	30,05,000

5. Cash and bank balances

Cash and cash equivalents	
Current account balance	45,000
Cash	8,000
Other bank balances	Nil
	53,000

6. Short-term loans and Advances

Loan to directors	80,000

7. Other Income

Rent received	46,000
Transfer fees	10,000
	56,000

8. Cost of materials consumed

*P*urchases	23,19,000

9. Changes in inventory of finished goods, WIP & Stock in trade

Opening inventory	6,80,000	
Closing inventory	8,23,000	(1,43,000)

10. Employee benefit expense

Wages	9,00,000

11. Finance cost	
Interest on bank loans	1,16,000
Debenture interest	55,000
	1,71,000
12. Other Expenses	
Consumables	84,000
Preliminary expenses	10,000
Bad debts	35,000
Discount	40,000
Rentals	25,000
Commission	1,20,000
Advertisement	20,000
Dealers' aids	21,000
Transit insurance	30,000
Trade expenses	37,000
Distribution freight	54,000
	4,76,000

Illustration 7

You are required to prepare a Statement of Profit and Loss and Balance Sheet from the following Trial Balance extracted from the books of the International Hotels Ltd., on 31st March, 20X2:

	Dr. ₹	*Cr.* ₹
Authorised Capital-divided into 5,000 6% Preference Shares of ₹100 each and 10,000 equity Shares of ₹100 each		*15,00,000*
Subscribed Capital -		
5,000 6% Preference Shares of ₹100 each		*5,00,000*
Equity Capital		*8,05,000*
Purchases - Wines, Cigarettes, Cigars, etc.	*45,800*	
- Foodstuffs	*36,200*	
Wages and Salaries	*28,300*	
Rent, Rates and Taxes	*8,900*	
Laundry	*750*	
Sales - Wines, Cigarettes, Cigars, etc.		*68,400*
- Food		*57,600*

Coal and Firewood		*3,290*	
Carriage and Cooliage		*810*	
Sundry Expenses		*5,840*	
Advertising		*8,360*	
Repairs		*4,250*	
Rent of Rooms			*48,000*
Billiard			*5,700*
Miscellaneous Receipts			*2,800*
Discount received			*3,300*
Transfer fees			*700*
Freehold Land and Building		*8,50,000*	
Furniture and Fittings		*86,300*	
Inventory on hand, 1st April, 20X1			
Wines, Cigarettes. Cigars, etc.		*12,800*	
Foodstuffs		*5,260*	
Cash in hand		*2,200*	
Cash with Bankers		*76,380*	
Preliminary and formation expenses		*8,000*	
2,000 Debentures of ₹100 each (6%)			*2,00,000*
Profit and Loss Account			*41,500*
Trade payables			*42,000*
Trade receivables		*19,260*	
Investments		*2,72,300*	
Goodwill at cost		*5,00,000*	
General Reserve			*2,00,000*
		19,75,000	*19,75,000*
Wages and Salaries Outstanding	*1,280*		
Inventory on 31st March, 20X2			
Wines, Cigarettes and Cigars, etc.	*22,500*		
Foodstuffs	*16,400*		

Depreciation :

Furniture and Fittings @ 5% p.a. : Land and Building @ 2% p.a.

The Equity capital on 1st April, 20X1 stood at ₹7,20,000, that is 6,000 shares fully paid and 2,000 shares ₹60 paid. The directors made a call of ₹40 per share on 1st October 20X1. A

shareholder could not pay the call on 100 shares and his shares were then forfeited and reissued @ ₹90 per share as fully paid. The Directors declare a dividend of 8% on equity shares, transferring any amount that may be required from General Reserve. Ignore Taxation.

Solution

Statement of Profit and Loss of International Hotels Ltd.
for the year ended 31st March, 20X2

	Particulars	*Notes*	*Amount*
I.	Revenue from operations	10	1,83,200
II.	Other income (Discount received)		3,300
III.	**Total Revenue (I + II)**		**1,86,500**
IV.	**Expenses:**		
	Cost of materials consumed	11	25,060
	Purchases of Inventory-in-Trade	12	45,800
	Changes in inventories of finished goods work-in-progress and Inventory-in-Trade	13	(9,700)
	Employee benefits expense	14	29,580
	Other operating expenses	15	18,000
	Selling and administrative expenses	16	14,200
	Finance costs	17	12,000
	Depreciation and amortisation expense	18	21,315
	Other expenses	9	8,000
	Total expenses		**1,64,255**
V.	**Profit (Loss) for the period (III - IV)**		**22,245**

Balance Sheet of International Hotels Ltd. as on 31st March, 20X2

Particulars	*Note No*	*₹*
Equity and Liabilities		
1 Shareholders' funds		
a Share capital	1	13,00,000
b Reserves and Surplus	2	1,74,745
2 Non-current liabilities		
a Long-term borrowings	3	2,00,000
3 Current liabilities		
a Trade Payables	4	42,000

b Other current liabilities	5	1,07,280
Total		**18,24,025**
ASSETS		
1 Non-current assets		
a Fixed assets		
i Tangible assets	6	9,14,985
ii Intangible assets (Goodwill)		5,00,000
b Non-current investments		2,72,300
2 Current assets		
a Inventories	7	38,900
b Trade receivables		19,260
c Cash and bank balances	8	78,580
Total		**18,24,025**

Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	Authorised		
	10,000 Equity shares of ₹ 100 each		10,00,000
	Issued & subscribed		
	8,000 Equity Shares of ₹100 each		8,00,000
	Preference share capital		
	Authorised		
	5,000 6% Preference shares of ₹ 100 each		5,00,000
	Issued & subscribed		
	5,000 6% Preference shares of ₹ 100 each		5,00,000
	Total		**13,00,000**
2	**Reserves and Surplus**		
	Capital reserve [100 x (90 – 40)]		5,000
	General reserve	2,00,000	
	Less : Amount used to pay dividend	(30,255)	1,69,745
	Surplus (Profit & Loss A/c)	22,245	
	Add: Balance from previous year	41,500	
	Transfer from General Reserve (94,000 – 41,500)	30,255	

	Appropriations		
	Dividend declared	(94,000)	-
	Profit (Loss) carried forward to Balance Sheet	**0**	0
	Total		**1,74,745**
3	**Long-term borrowings**		
	Secured		
	6% Debentures		2,00,000
	Total		**2,00,000**
4	**Trade Payables**		42,000
5	**Other current liabilities**		
	Wages and Salaries Outstanding	1,280	
	Interest on debentures	12,000	13,280
	dividend payable		
	Preference Dividend (5,00,000 x 6%)		30,000
	Equity Dividend (8,00,000 x 8%)		64,000
	Total		**1,07,280**
6	**Tangible assets**		
	Freehold land & Buildings	8,50,000	
	Less: Depreciation	(17,000)	8,33,000
	Furniture and Fittings	86,300	
	Less: Depreciation	(4,315)	81,985
	Total		**9,14,985**
7	**Inventories**		
	Wines, Cigarettes & Cigars, etc.		22,500
	Foodstuffs		16,400
	Total		**38,900**
8	**Cash and bank balances**		
	Cash and cash equivalents		
	Cash at bank		76,380
	Cash in hand		2,200
	Other bank balances		Nil
	Total		**78,580**
9	**Other expenses**		
	Preliminary Expenses*		8,000
	Total		**8,000**

* As per AS 26, preliminary expenses are not shown in the balance sheet.

10	**Revenue from operations**		
	Sale of products		
	Wines, Cigarettes, Cigars etc.	68,400	
	Food	57,600	1,26,000
	Sale of services		
	Room Rent	48,000	
	Billiards	5,700	
	Transfer fees	700	
	Miscellaneous Receipts	2,800	
			57,200
	Total		**1,83,200**
11	**Cost of materials consumed**		
	Opening Inventory	5,260	
	Add: Purchases during the year	36,200	
	Less: Closing Inventory	(16,400)	25,060
	Total		**25,060**
12	**Purchases of Inventory-in-Trade**		
	Wines, Cigarettes etc.		45,800
	Total		**45,800**
13	**Changes in inventories of finished goods work-in-progress and Inventory-in-Trade**		
	Wines, Cigarettes etc.		
	Opening Inventory	12,800	
	Less: Closing Inventory	(22,500)	(9,700)
	Total		**(9,700)**
14	**Employee benefits expense**		
	Wages and Salaries	28,300	
	Add: Wages and Salaries Outstanding	1,280	29,580
	Total		**29,580**
15	**Other operating expenses**		
	Rent, Rates and Taxes		8,900
	Coal and Firewood		3,290
	Laundry		750
	Carriage and Cooliage		810
	Repairs		4,250
	Total		**18,000**

16	**Selling and administrative expenses**			
	Advertising			8,360
	Sundry Expenses			5,840
		Total		**14,200**
17	**Finance costs**			
	Interest on Debentures (2,00,000 x 6%)			12,000
		Total		**12,000**
18	**Depreciation and amortisation expense**			
	Land and Buildings (8,50,000 x 2%)		17,000	
	Furniture & Fittings (86,300 x 5%)		4,315	21,315
		Total		**21,315**

Illustration 8

From the following particulars furnished by Pioneer Ltd., prepare the Balance Sheet as at 31st March, 20X1 as required by Schedule III of the Companies Act. Give notes at the foot of the Balance Sheet as may be found necessary -

		Debit	*Credit*
		₹	*₹*
Equity Capital (Face value of ₹100)			*10,00,000*
Calls in Arrears		*1,000*	
Land		*2,00,000*	
Building		*3,50,000*	
Plant and Machinery		*5,25,000*	
Furniture		*50,000*	
General Reserve			*2,10,000*
Loan from State Financial Corporation			*1,50,000*
Inventory :			
Finished Goods	*2,00,000*		
Raw Materials	*50,000*	*2,50,000*	
Provision for Taxation			*68,000*
Trade receivables		*2,00,000*	
Advances		*42,700*	
Dividend Payable			*60,000*
Profit and Loss Account			*86,700*
Cash Balance		*30,000*	
Cash at Bank		*2,47,000*	
Loans (Unsecured)			*1,21,000*
Trade payables (For Goods and Expenses)			*2,00,000*
		18,95,700	*18,95,700*

The following additional information is also provided :

(1) 2,000 equity shares were issued for consideration other than cash.

(2) Trade receivables of ₹52,000 are due for more than six months.

(3) The cost of assets:

Building	*₹4,00,000*
Plant and Machinery	*₹7,00,000*
Furniture	*₹62,500*

(4) The balance of ₹1,50,000 in the loan account with State Finance Corporation is inclusive of ₹7,500 for interest accrued but not due. The loan is secured by hypothecation of the Plant and Machinery.

(5) Balance at Bank includes ₹2,000 with Perfect Bank Ltd., which is not a Scheduled Bank.

(6) The company had contract for the erection of machinery at ₹1,50,000 which is still incomplete.

Solution

Pioneer Ltd.
Balance Sheet as on 31st March, 20X1

		Particulars	*Notes*	*₹*
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	9,99,000
	b	Reserves and Surplus	2	2,96,700
2		**Non-current liabilities**		
	a	Long-term borrowings	3	2,63,500
3		**Current liabilities**		
	a	Trade Payables		2,00,000
	b	Other current liabilities	4	67,500
	c	Short-term provisions	5	68,000
		Total		**18,94,700**
		Assets		
1		**Non-current assets**		
	a	Fixed assets		
		Tangible assets	6	11,25,000
2		**Current assets**		
	a	Inventories	7	2,50,000

b	Trade receivables	8	2,00,000
c	Cash and bank balances	9	2,77,000
d	Short-term loans and advances		42,700
	Total		**18,94,700**

Notes to accounts

			₹.
1	**Share Capital**		
	Equity share capital		
	Issued & subscribed & called up		
	10,000 Equity Shares of ₹100 each	10,00,000	
	(Of the above 2,000 shares have been issued for consideration other than cash)		
	Less: Calls in arrears	(1,000)	9,99,000
	Total		**9,99,000**
2	**Reserves and Surplus**		
	General Reserve		2,10,000
	Surplus (Profit & Loss A/c)		86,700
	Total		**2,96,700**
3	**Long-term borrowings**		
	Secured		
	Term Loans		
	Loan from State Financial Corporation (1,50,000 – 7,500)		1,42,500
	(Secured by hypothecation of Plant and Machinery)		
	Unsecured loan		1,21,000
	Total		**2,63,500**
4	**Other current liabilities**		
	Interest accrued but not due on loans (SFC)		7,500
	Dividend Payable		60,000
	Total		**67,500**
5	**Short-term provisions**		
	Provision for taxation		68,000
	Total		**68,000**
6	**Tangible assets**		
	Land		2,00,000
	Buildings	4,00,000	
	Less: Depreciation	(50,000) (b.f.)	3,50,000

	Plant & Machinery	7,00,000	
	Less: Depreciation	(1,75,000) (b.f.)	5,25,000
	Furniture & Fittings	62,500	
	Less: Depreciation	(12,500) (b.f.)	50,000
	Total		**11,25,000**
7	**Inventories**		
	Raw Material		50,000
	Finished goods		2,00,000
	Total		**2,50,000**
8	**Trade receivables**		
	Debts outstanding for a period exceeding six months		52,000
	Other Debts		1,48,000
	Total		**2,00,000**
9	**Cash and bank balances**		
	Cash and cash equivalents		
	Cash at bank		
	with Scheduled Banks	2,45,000	
	with others (Perfect Bank Ltd.)	2,000	2,47,000
	Cash in hand		30,000
	Other bank balances		Nil
	Total		**2,77,000**

Note: Estimated amount of contract remaining to be executed on capital account and not provided for ₹1,50,000. It has been assumed that the company had given this contract for purchase of machinery.

Summary

- Meaning of Company has been defined Companies Act,2013.
- Books of accounts should be maintained at Registered office of company.
- Proper books are not deemed to be kept if they do not provide a true and fair view of state of affairs of company.
- A number of Statutory Books have been prescribed under Companies Act which is to be maintained along with statistical books to keep a record of all transactions.
- Annual Return is to be filed by every company within 60 days of holding Annual general meeting.

- Financial statements of a company should be as per schedule III and they should give true and fair view.
- Managerial Remuneration calculated as a percentage on profit and is governed by various sections of the Companies Act, 2013 (namely Section 197 and Section 198) and Schedule V to the Companies Act, 2013.
- Following things have been dealt with under various sections :
  - Overall maximum managerial remuneration payable
  - Managerial remuneration in case of absence or inadequacy of profits
  - Remuneration payable to whole-time directors and part-time directors
  - Ascertaining net profit of company
  - Remuneration of manager
- Determining amount of profits available for distribution is an important function and depends on a number of factors, like their composition, the amount of provisions and appropriations that must be made out of them in priority, etc.
- Capital cannot be returned to shareholders by way of dividend.
- Appropriating a part of profits may be done as a result of decision of Board of directors or as per law.
- Dividend may be declared out of reserves subject to certain conditions. Dividends cannot be declared except out of profits. Dividend Distribution Tax is the amount charged on amount declared as dividend distributed or paid by such company by way of dividends (whether interim or otherwise).
- Capital reserves include reserves which are not intended for distribution and include profit prior to incorporation, on sale of fixed assets, profit on reissue of forfeited shares, credit balance in capital reduction account. In short only profits or a surplus of a capital nature can be credited to such a reserve.
- Holders of preference shares are entitled to receive a dividend at a fixed rate before any dividend is declared on equity shares.

Unit – 2 : Cash Flow Statement

Learning Objectives

After studying this unit, you will be able to:

- Define cash flow statement as per AS 3
- Differentiate operating, investing and financing activities
- Learn the various elements of cash and cash equivalents
- Prepare cash flow statement both by direct method and indirect method.

2.1 Introduction

Accounting Standard 3, Cash Flow Statements, was issued in March, 2004. It is based on cash concept of profit. Cash Flow refers both cash and cash equivalents. This statement provides relevant information in assessing a company's liquidity, quality of earnings and solvency.

Benefits:

(a) Cash flow statement provides information about the changes in cash and cash equivalents of an enterprise.

(b) Identifies cash generated from trading operations.

(c) The operating cash surplus which can be applied for investment in fixed assets.

(d) Portion of cash from operations is used to pay dividend and tax and the other portion is ploughed back.

(e) Very useful tool of planning.

Purpose:

Cash flow statements are prepared to explain the cash movements between two points of time.

Sources of Cash:

1. Issue of shares and debentures and raising long-term loan.
2. Sale of investments and other fixed assets.
3. Cash from operations (Net Operating Profit)
4. Decrease in Cash.

Applications of Cash

1. Redemption of preference shares and debentures and repayment of long-term loan.

2. Purchase of investments and other fixed assets.
3. Payment of tax.
4. Payment of dividend.
5. Increase in cash.
6. Loss on Operation (Net Operating Loss)

Note – Cash includes Bank A/c also. Increase in cash or decrease in cash is put in the applications and the sources respectively just to balance the cash flow statement.

At this juncture students may note that in cash flow statement changes in all balance sheet items are to be taken into consideration separately for explaining movement of cash.

2.2 Elements of Cash

As per AS 3, issued by the Council of the ICAI, 'Cash' include:

(i) Cash in hand,

(ii) Demand deposits with banks, and

(iii) Cash equivalents.

(a) Components

- Short term highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value
- Securities with short maturity period of, say, three months or less from the date of acquisition

(b) Objective

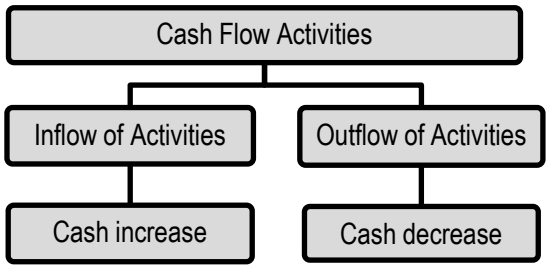
- Deploy, for a short period, idle cash required to meet short-term cash-commitments.

(c) Examples

- Acquisition of preference shares, shortly before their specified redemption date, bank deposits with short maturity period, etc.

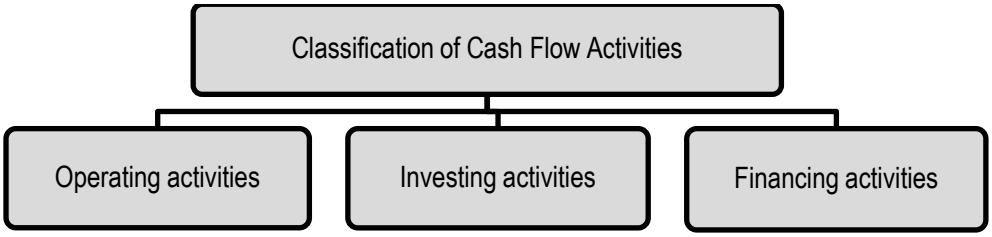
Conclusion: Thus, cash flow statement deals with flow of cash funds but does not consider the movements among cash, bank balance payable on demand and investment of excess cash in cash equivalents. Examples are cash withdrawn from current account, cash deposited in bank for 60 days, etc.

2.3 Classification of Cash Flow Activities



AS 3 provides explanation for changes in cash position of the business entity.

As per Accounting Standard 3, cash flows during the period are classified as



2.3.1 Operating Activities

1. *Definition:* These are the principal revenue generating activities of the enterprise.
2. *Net Impact*: Net impact of operating activities on flow of cash is reported as 'Cash flows from operating activities' or 'cash from operation'.
3. *Key Indicator:* The amount of cash flows from operating activities is a key indicator of the extent to which the operations of the enterprises have generated sufficient cash flows to :
   (a) Maintain the operating capability of the enterprise,
   (b) Pay dividends, repay loans, and
   (c) Make new investments without recourse to external sources of financing.
4. *Information Provided:* It provides useful information about internal financing.
5. *Benefits:* Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows.

2.3.2 Investing activities

1. *Definition*: These are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

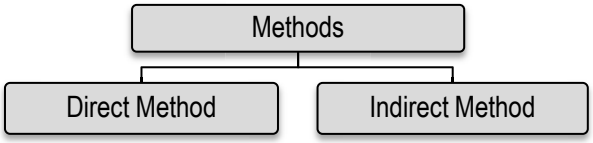
2. *Separate Disclosure*: Separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which the expenditures have been made for resources intended to generate future incomes and cash flows.

2.3.3 Financing activities

1. *Definition*: These are the activities that result in changes in the size and composition of the owner's capital (including preference share capital) and borrowings of the enterprise.
2. *Separate Disclosure*: 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 funds (both capital and borrowings) to the enterprise.

2.4 Calculation of Cash Flows from Operating Activities

1. *Components:* Cash flows from operating activities result from the transactions and other events that enter into the determination of net profit or loss.
2. *Examples*
   (a) cash receipts from the sale of goods and the rendering of services;
   (b) cash receipt from fees, commission and other revenue;
   (c) cash payments to suppliers for goods; cash payments to employees and so on.
3. *Methods*: An enterprise can determine cash flows from operating activities using either:



(a) Direct Method: The direct method, whereby major classes of gross cash receipts and gross cash payments are considered; or

(b) Indirect Method: The indirect method, whereby net 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 expense associated with investing or financing activities.

2.4.1 Direct Method

1. *Information Required*
   (a) Gross receipts and gross cash payments may be obtained from the accounting records to ascertain cash flows from operating activities.
   (b) For example,
      (i) information about cash received from trade receivables,

(ii) payment to trade payables, cash expenses etc., which may be obtained by an analysis of cash book.

(c) In actual practice, the relevant information is obtained by adjusting sales, cost of sales and other items in the profit and loss accounts for:

- Changes during the period in inventories and operating receivables and payables;
- Other non-cash items such as depreciation on fixed assets, goodwill written off, preliminary expenses written off, loss or gain on sale of fixed assets etc.; and
- Other items for which the cash effects are investing or financing cash flows. Examples are interest received and paid, dividend received and paid etc., which are related to financing or investing activities and are shown separately in the cash flow statement.
- This procedure of computation of cash flows from operating activities is also known as income statement method.

2. The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method and is, therefore, considered more appropriate than the indirect method.
3. However, indirect method of determining the cash from operating activities is more popular in actual practice.

2.4.2 Indirect Method

Method of Determination

Under the indirect method, the net cash from operating activities is determined by adjusting net profit or loss instead of individual items appearing in the profit and loss account. Net profit or loss is also adjusted for the effect of:

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

(b) non-cash items such as depreciation; and

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

(d) The indirect method is also known as 'reconciliation method'.

2.4.3 Conclusion

1. It is worth noting that both direct and indirect methods adjust current assets and current liabilities related to operating activities to determine cash from operating activities.
2. But direct method adjust individual items of profit and loss account and indirect method adjusts overall net profit (or loss) to determine cash from operation.

3. Therefore, indirect method fails to provide break-up of cash from operations.

Proforma of 'Cash Flow from Operating Activities' by indirect method

		₹
Net Profit for the year		-
Add: Non-Cash and Non-Operating Expenses:	-	
Depreciation	-	
Share Discount Written off	-	
Loss on Sale of Assets	-	
Provision for taxation, etc.	-	
Less: Non-Cash and Non-Operating Incomes:		
Profit on Sale of Assets	-	
Net Profit after Adjustment for Non-Cash Items		(-)

Cash from operation	=	Net Profit (after adjustment for Non-cash Items)
	-	Increase in Current Assets
	+	Decrease in Current Asset
	+	Increase in Current Liabilities
	-	Decrease in Current Liability

2.5 Calculation of Cash Flows from Investing Activities

1. These activities are related to the acquisition and disposal of long-term assets, non-operating current assets and investments which results in outflow of cash.
2. Disposal of the aforesaid assets results in inflow of cash.
3. Thus, inflows and outflows related to acquisition and disposal of assets, other than those related to operating activities, are shown under this category

2.6 Calculation of Cash Flows from Financing Activities

1. These activities are basically related to the changes in capital and borrowing of the enterprise which affect flow of cash.
2. Redemption of shares and repayment of borrowings results in outflow of cash.
3. Thus inflows and outflows related to the amount of capital and borrowings of the enterprise are shown under this head.

Students are advised to refer full text of revised Accounting Standard on Cash Flow Statements (AS 3) for the better understanding of the chapter.

2.7 Illustrations

Illustration 1

Following are the extracts of Balance Sheet of Ajay Ltd.:

Liabilities	*31.3.2014*	*31.3.2015*	*Assets*	*31.3.2014*	*31.3.2015*
	₹	₹			₹
Share Capital	*5,00,000*	*5,00,000*	*Discount on*		
15% Debentures	*5,00,000*	*7,50,000*	*issue of shares*	*1,15,000*	*90,000*
Unpaid Interest	--	*5,000*	*Discount on issue*		
Profit & Loss A/c	*50,000*	*90,000*	*of Debentures*	*90,000*	*1,15,000*

You are required to show the related items in Cash Flow Statement, if Discount on issue of Debentures amounting to ₹ 10,000 has been written off during the year.

Solution

An Extract of Cash Flow Statement for the year ending 31.3.2015

	₹
Closing balance as per Profit & Loss A/c	90,000
Less: Opening balance as per Profit & Loss Alc.	(50,000)
Add: Discount on issue of Shares	25,000
Add: Discount on issue of Debentures	10,000
Interest on Debentures	75,000
Net Cash from Operating Activities	1,50,000

Cash flows from financing activities:

Proceeds from debentures	2,15,000
Interest paid on Debentures [less unpaid]	(70,000)
Net Cash from Financing Activities	1,45,000

Working Note:

(i) Discount on issue of Debentures Account

Particulars	₹	*Particular*	₹
To Balance b/d	90,000	By Profit & Loss A/c (w/o)	10,000
To 15% Debentures A/c (Bal. fig.)	35,000	By Balance c/d	1,15,000
	1,25,000		1,25,000

(ii) 15% Debentures Account

Particulars	₹	*Particular*	₹
To Balance c/d	7,50,000	By Balance b/d	5,00,000
		By Bank A/c (Bal. fig.)	2,15,000
		By Discount on issue of Debentures A/c	35,000
	7,50,000		7,50,000

Illustration 2

From the following information, calculate cash flow from operating activities:

Summary of Cash Account
for the year ended March 31, 2015

Particulars	₹	*Particulars*	₹
To Balance b/d	*1,00,000*	*By Cash Purchases*	*1,20,000*
To Cash sales	*1,40,000*	*By Trade payables*	*1,57,000*
To Trade receivables	*1,75,000*	*By Office & Selling Expenses*	*75,000*
To Trade Commission	*50,000*	*By Income Tax*	*30,000*
To Sale of Investment	*30,000*	*By Investment*	*25,000*
To Loan from Bank	*1,00,000*	*By Repay of Loan*	*75,000*
To Interest & Dividend	*1,000*	*By Interest on loan*	*10,000*
		By Balance c/d	*1,04,000*
	5,96,000		*5,96,000*

Solution

Cash Flow Statement of ……
for the year ended March 31, 2015 (Direct Method)

Particulars	₹	₹
Operating Activities:		
Cash received from sale of goods	1,40,000	
Cash received from Trade receivables	1,75,000	
Trade Commission received	50,000	3,65,000
Less: Payment for Cash Purchases	1,20,000	
Payment to Trade payables	1,57,000	
Office and Selling Expenses	75,000	
Payment for Income Tax	30,000	(3,82,000)
Net Cash Flow used in Operating Activities		(17,000)

Illustration 3

The following summary cash account has been extracted from the company's accounting records:

Summary Cash Account

		(₹ '000)
Balance at 1.3.2014		*35*
Receipts from customers		*2,783*
Issue of shares		*300*
Sale of fixed assets		*128*
		3,246
Payments to suppliers	*2,047*	
Payments for fixed assets	*230*	
Payments for overheads	*115*	
Wages and salaries	*69*	
Taxation	*243*	
Dividends	*80*	
Repayments of bank loan	*250*	*(3,034)*
Balance at 31.12.2014		*212*

Prepare Cash Flow Statement of this company Hills Ltd. for the year ended 31st March, 2015 in accordance with AS-3 (Revised).

The company does not have any cash equivalents.

Solution

Hills Ltd.
Cash Flow Statement for the year ended 31st March, 2015
(Using direct method)

		(₹ '000)
Cash flows from operating activities		
Cash receipts from customers	2,783	
Cash payments to suppliers	(2,047)	
Cash paid to employees	(69)	
Other cash payments (for overheads)	(115)	
Cash generated from operations	552	
Income taxes paid	(243)	
Net cash from operating activities		309
Cash flows from investing activities		
Payments for purchase of fixed assets	(230)	
Proceeds from sale of fixed assets	128	

Net cash used in investing activities		(102)
Cash flows from financing activities		
Proceeds from issuance of share capital	300	
Bank loan repaid	(250)	
Dividend paid	(80)	
Net cash used in financing activities		(30)
Net increase in cash and cash equivalents		177
Cash and cash equivalents at beginning of period		35
Cash and cash equivalents at end of period		212

Illustration 4

The following data were provided by the accounting records of Ryan Ltd. at year-end, March 31, 2015:

Income Statement

		₹
Sales		*6,98,000*
Cost of Goods Sold		*(5,20,000)*
Gross Margin		*1,78,000*
Operating Expenses		
(including Depreciation Expense of ₹ 37,000)		*(1,47,000)*
		31,000
Other Income / (Expenses)		
Interest Expense paid	*(23,000)*	
Interest Income received	*6,000*	
Gain on Sale of Investments	*12,000*	
Loss on Sale of Plant	*(3,000)*	
		(8,000)
		23,000
Income tax		*(7,000)*
		16,000

Comparative Balance Sheets ₹

	31st March 2015	*31st March 2014*
Assets		
Plant Assets	*7,15,000*	*5,05,000*
Less: Accumulated Depreciation	*(1,03,000)*	*(68,000)*
	6,12,000	*4,37,000*

Investments (Long term)	*1,15,000*	*1,27,000*
Current Assets:		
Inventory	*1,44,000*	*1,10,000*
Accounts receivable	*47,000*	*55,000*
Cash	*46,000*	*15,000*
Prepaid expenses	*1,000*	*5,000*
	9,65,000	*7,49,000*
Liabilities		
Share Capital	*4,65,000*	*3,15,000*
Reserves and surplus	*1,40,000*	*1,32,000*
Bonds	*2,95,000*	*2,45,000*
Current liabilities:		
Accounts payable	*50,000*	*43,000*
Accrued liabilities	*12,000*	*9,000*
Income taxes payable	*3,000*	*5,000*
	9,65,000	*7,49,000*

Analysis of selected accounts and transactions during 2014-15

1. *Purchased investments for ₹ 78,000.*
2. *Sold investments for ₹ 1,02,000. These investments cost ₹ 90,000.*
3. *Purchased plant assets for ₹ 1,20,000.*
4. *Sold plant assets that cost ₹ 10,000 with accumulated depreciation of ₹ 2,000 for ₹ 5,000.*
5. *Issued ₹ 1,00,000 of bonds at face value in an exchange for plant assets on 31st March, 2015.*
6. *Repaid ₹ 50,000 of bonds at face value at maturity.*
7. *Issued 15,000 shares of ₹ 10 each.*
8. *Paid cash dividends ₹ 8,000.*

Prepare Cash Flow Statement as per AS-3 (Revised), using indirect method.

Solution

Ryan Ltd.
Cash Flow Statement
for the year ending 31st March, 2015

	₹	₹
Cash flows from operating activities		
Net profit before taxation	23,000	
Adjustments for:		

Depreciation	37,000	
Gain on sale of investments	(12,000)	
Loss on sale of plant assets	3,000	
Interest expense	23,000	
Interest income	(6,000)	
Operating profit before working capital changes	68,000	
Decrease in accounts receivable	8,000	
Increase in inventory	(34,000)	
Decrease in prepaid expenses	4,000	
Increase in accounts payable	7,000	
Increase in accrued liabilities	3,000	
Cash generated from operations	56,000	
Income taxes paid*	(9,000)	
Net cash generated from operating activities		47,000
Cash flows from investing activities		
Purchase of plant assets	(1,20,000)	
Sale of plant assets	5,000	
Purchase of investments	(78,000)	
Sale of investments	1,02,000	
Interest received	6,000	
Net cash used in investing activities		(85,000)
Cash flows from financing activities		
Proceeds from issuance of share capital	1,50,000	
Repayment of bonds	(50,000)	
Interest paid	(23,000)	
Dividends paid	(8,000)	
Net cash from financing activities		69,000
Net increase in cash and cash equivalents		31,000
Cash and cash equivalents at the beginning of the period		15,000
Cash and cash equivalents at the end of the period		46,000

***Working Note:**

	₹
Income taxes paid:	
Income tax expense for the year	7,000
Add: Income tax liability at the beginning of the year	5,000
	12,000
Less: Income tax liability at the end of the year	(3,000)
	9,000

Illustration 5

The balance sheets of Sun Ltd. for the years ended 31st March 2015 and 2014 were summarised as:

	2015 ₹	2014 ₹
Equity Share Capital	60,000	50,000
Reserves:		
Profit and Loss Account	5,000	4,000
Current Liabilities:		
Trade payables	4,000	2,500
Taxation	1,500	1,000
Dividends payable	2,000	1,000
	72,500	58,500
Fixed Assets (at w.d.v.)		
Premises	10,000	10,000
Fixtures	17,000	11,000
Vehicles	12,500	8,000
Short-term investments	2,000	1,000
Current Assets		
Inventory	17,000	14,000
Trade receivables	8,000	6,000
Bank and Cash	6,000	8,500
	72,500	58,500

The profit and loss account for the year ended 31st March, 2015 disclosed

	₹
Profit before tax	4,500
Taxation	(1,500)
Profit after tax	3,000
Declared dividends	(2,000)
Retained profit	1,000

Further information is available

	Fixtures ₹	Vehicles ₹
Depreciation for year	1,000	2,500
Disposals:		
Proceeds on disposal	—	1,700
Written down value	—	(1,000)
Profit on disposal		700

Prepare a Cash Flow Statement for the year ended 31st March, 2015.

Solution

Sun Ltd.
Cash Flow Statement
for the year ended 31st March, 2015

	₹	₹
Cash flows from operating activities		
Net Profit before taxation	4,500	
Adjustments for:		
Depreciation	3,500	
Profit on sale of vehicles	(700)	
Operating profit before working capital changes	7,300	
Increase in Trade receivables	(2,000)	
Increase in inventories	(3,000)	
Increase in Trade payables	1,500	
Cash generated from operations	3,800	
Income taxes paid	(1,000)	
Net cash generated from operating activities		2,800
Cash flows from investing activities		
Sale of vehicles	1,700	
Purchase of vehicles	(8,000)	
Purchase of fixtures	(7,000)	
Net cash used in investing activities		(13,300)
Cash flows from financing activities		
Issue of shares for cash	10,000	
Dividends paid	(1,000)	
Net cash from financing activities		9,000
Net decrease in cash and cash equivalents		(1,500)
Cash and cash equivalents at beginning of period (See Note 1)		9,500
Cash and cash equivalents at end of period (See Note 1)		8,000

Note to the Cash Flow Statement

Cash and Cash Equivalents

	31.3.2015	*31.3.2014*
Bank and Cash	6,000	8,500
Short-term investments	2,000	1,000
Cash and cash equivalents	8,000	9,500

Working Notes:

		₹
1.	Income taxes paid	
	Income tax expense for the year	1,500
	Add: Income tax liability at the beginning of the year	1,000
		2,500
	Less: Income tax liability at the end of the year	(1,500)
		1,000
2.	Dividend paid	
	Declared dividend for the year	2,000
	Add: Amount payable at the beginning of the year	1,000
		3,000
	Less: Amount payable at the end of the year	(2,000)
		1,000

3. Fixed assets acquisitions

	Fixtures ₹	*Vehicles* ₹
W.D.V. at 31.3.2015	17,000	12,500
Add back:		
Depreciation for the year	1,000	2,500
Disposals	—	1,000
	18,000	16,000
Less: W.D.V. at 31.12.2014	(11,000)	(8,000)
Acquisitions during 2014-2015	7,000	8,000

Illustration 6

Ms. Jyoti of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year ended 31st March, 2015 :

	(₹ in lakhs)
Net Profit	*25,000*
Dividend (including dividend tax) paid	*8,535*
Provision for Income tax	*5,000*
Income tax paid during the year	*4,248*
Loss on sale of assets (net)	*40*
Book value of the assets sold	*185*

Depreciation charged to Profit & Loss Account	*20,000*
Profit on sale of Investments	*100*
Carrying amount of Investment sold	*27,765*
Interest income on investments	*2,506*
Interest expenses of the year	*10,000*
Interest paid during the year	*10,520*
Increase in Working Capital (excluding Cash & Bank Balance)	*56,081*
Purchase of fixed assets	*14,560*
Investment in joint venture	*3,850*
Expenditure on construction work in progress	*34,740*
Proceeds from calls in arrear	*2*
Receipt of grant for capital projects	*12*
Proceeds from long-term borrowings	*25,980*
Proceeds from short-term borrowings	*20,575*
Opening cash and Bank balance	*5,003*
Closing cash and Bank balance	*6,988*

Prepare the Cash Flow Statement for the year 2015 in accordance with AS 3. (Make necessary assumptions).

Solution

Star Oils Limited
Cash Flow Statement
for the year ended 31st March, 2015

(₹ in lakhs)

Cash flows from operating activities	
Net profit before taxation (25,000 + 5,000)	30,000
Adjustments for :	
Depreciation	20,000
Loss on sale of assets (Net)	40
Profit on sale of investments	(100)
Interest income on investments	(2,506)
Interest expenses	10,000

Operating profit before working capital changes	57,434	
Changes in working capital (Excluding cash and bank balance)	(56,081)	
Cash generated from operations	1,353	
Income taxes paid	(4,248)	
Net cash used in operating activities		(2,895)
Cash flows from investing activities		
Sale of assets	145	
Sale of investments (27,765 + 100)	27,865	
Interest income on investments	2,506	
Purchase of fixed assets	(14,560)	
Investment in joint venture	(3,850)	
Expenditure on construction work-in progress	(34,740)	
Net cash used in investing activities		(22,634)
Cash flows from financing activities		
Proceeds from calls in arrear	2	
Receipts of grant for capital projects	12	
Proceeds from long-term borrowings	25,980	
Proceed from short-term borrowings	20,575	
Interest paid	(10,520)	
Dividend (including dividend tax) paid	(8,535)	27,514
Net increase in cash and cash equivalents		1,985
Cash and cash equivalents at the beginning of the period		5,003
Cash and cash equivalents at the end of the period		6,988

Working note :

Book value of the assets sold	185
Less : Loss on sale of assets	(40)
Proceeds on sale	145

Assumption :

Interest income on investments ₹ 2,506 has been received during the year.

Illustration 7

From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 2015 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31.3.2015

	₹ '000		₹ '000
Balance on 1.4.2014	*50*	*Payment to Suppliers*	*2,000*
Issue of Equity Shares	*300*	*Purchase of Fixed Assets*	*200*
Receipts from Customers	*2,800*	*Overhead expense*	*200*
Sale of Fixed Assets	*100*	*Wages and Salaries*	*100*
		Taxation	*250*
		Dividend	*50*
		Repayment of Bank Loan	*300*
		Balance on 31.3.2015	*150*
	3,250		*3,250*

Solution

X Ltd.
Cash Flow Statement for the year ended 31st March, 2015
(Using direct method)

	₹ '000	₹ '000
Cash flows from operating activities		
Cash receipts from customers	2,800	
Cash payments to suppliers	(2,000)	
Cash paid to employees	(100)	
Cash payments for overheads	(200)	
Cash generated from operations	500	
Income tax paid	(250)	
Net cash generated from operating activities		250
Cash flows from investing activities		
Payments for purchase of fixed assets	(200)	
Proceeds from sale of fixed assets	100	
Net cash used in investing activities		(100)
Cash flows from financing activities		
Proceeds from issuance of equity shares	300	
Bank loan repaid	(300)	
Dividend paid	(50)	
Net cash used in financing activities		(50)
Net increase in cash		100
Cash at beginning of the period		50
Cash at end of the period		150

Illustration 8

Given below is the Statement of Profit and Loss of ABC Ltd. and relevant Balance Sheet information:

Statement of Profit and Loss of ABC Ltd.
for the year ended 31st March, 2015

	₹ in lakhs
Revenue:	
Sales	4,150
Interest and dividend	100
Stock adjustment	20
Total (A)	4,270
Expenditure:	
Purchases	2,400
Wages and salaries	800
Other expenses	200
Interest	60
Depreciation	100
Total (B)	3,560
Profit before tax (A – B)	710
Tax provision	200
Profit after tax	510
Balance of Profit and Loss account brought forward	50
Profit available for distribution (C)	560
Appropriations:	
Transfer to general reserve	200
Declared dividend (including CDT)	330
Total (D)	530
Balance (C – D)	30

Relevant Balance Sheet information	31.3.2015	31.3.2014
	₹ in lakhs	₹ in lakhs
Trade receivables	400	250
Inventories	200	180

Trade payables	*250*	*230*
Outstanding wages	*50*	*40*
Outstanding expenses	*20*	*10*
Advance tax	*195*	*180*
Tax provision	*200*	*180*
Assessed tax liability		

Compute cash flow from operating activities using both direct and indirect method.

Solution

By direct method

Computation of Cash Flow from Operating Activities

	₹ in lakhs	*₹ in lakhs*
Cash Receipts:		
Cash sales and collection from Trade receivables		
Sales + Opening Trade receivables – Closing Trade receivables (A)	4,150 + 250 – 400	4,000
Cash payments:		
Cash purchases & payment to Trade payables		
Purchases + Opening Trade payables – Closing Trade payables	2,400 + 230 – 250	2,380
Wages and salaries paid	800 + 40 – 50	790
Cash expenses	200 + 10 – 20	190
Taxes paid – Advance tax		195
(B)		3,555
Cash flow from operating activities (A – B)		445
By indirect method		
Profit before tax		710
Add: Non-cash items : Depreciation		100
Add: Interest : Financing cash outflow		60
Less: Interest and Dividend : Investment cash inflow		(100)
Less: Tax paid		(195)
Working capital adjustments		
Trade receivables	250–400 (150)	

Inventories	180–200	(20)	
Trade payables	250–230	20	
Outstanding wages	50–40	10	
Outstanding expenses	20–10	10	(130)
Cash flow from operating activities			445

Illustration 9

Prepare Cash flow for Gamma Ltd., for the year ending 31.3.2014 from the following information:

(1) Sales for the year amounted to ₹ 135 crores out of which 60% was cash sales.

(2) Purchases for the year amounted to ₹ 55 crores out of which credit purchase was 80%.

(3) Administrative and selling expenses amounted to ₹ 18 crores and salary paid amounted to ₹ 22 crores.

(4) The Company redeemed debentures of ₹ 20 crores at a premium of 10%. Debenture holders were issued equity shares of ₹ 15 crores towards redemption and the balance was paid in cash. Debenture interest paid during the year was ₹ 1.5 crores.

(5) Dividend paid during the year amounted to ₹ 11.7 crores(including Dividend distribution tax) was also paid.

(6) Investment costing ₹ 12 crores were sold at a profit of ₹ 2.4 crores.

(7) ₹ 8 crores was paid towards income tax during the year.

(8) A new plant costing ₹ 21 crores was purchased in part exchange of an old plant. The book value of the old plant was ₹ 12 crores but the vendor took over the old plant at a value of ₹ 10 crores only. The balance was paid in cash to the vendor.

(9) The following balances are also provided:

	₹ in crores 1.4.2013	₹ in crores 31.3.2014
Debtors	45	50
Creditors	21	23
Bank	6	

Answer

Gamma Ltd.

Cash Flow Statement for the year ended 31st March, 2014

(Using direct method)

Particulars	*₹ in crores*	*₹ in crores*
Cash flows from operating activities		
Cash sales (60% of 135)	81	
Cash receipts from Debtors [45+ (135x40%) - 50]	49	
Cash purchases (20% of 55)	(11)	
Cash payments to suppliers [21+ (55x80%) – 23]	(42)	
Cash paid to employees	(22)	
Cash payments for overheads (Adm. and selling)	(18)	
Cash generated from operations	37	
Income tax paid	(8)	
Net cash generated from operating activities		29
Cash flows from investing activities		
Sale of investments (12+ 2.40)	14.4	
Payments for purchase of fixed assets	(11)	
Net cash used in investing activities		3.4
Cash flows from financing activities		
Redemption of debentures (22-15)	(7)	
Interest paid	(1.5)	
Dividend paid	(11.7)	
Net cash used in financing activities		(20.2)
Net increase in cash		12.2
Cash at beginning of the period		6.0
Cash at end of the period		18.2

Summary

- Cash flow statement dealt under AS 3.
- Based on cash concept of profit.
- Benefits include providing information relating to changes in cash and cash equivalents of an enterprise.

- Useful tool of planning.
- Cash include :
  (a) Cash in hand
  (b) Demand deposits with banks
  (c) Cash equivalents.
- Cash flow activities may be classified as inflow and outflow but as per AS-3 they are classified as Operating Activities, Investing activities, Financing activities.
- Operating activities are principal revenue generating activities.
- Investing Activities relate to acquisition and disposal of long-term assets and other investments.
- Financing Activities include the ones which result in changes in the size and composition of the owner's capital (including preference share capital) and borrowings of the enterprise.
- Methods to calculate cash flow from operating activities include:
  (a) Direct Method
  (b) Indirect Method also known as reconciliation method.
- In order to calculate cash flow from investing activities inflows and outflows related to acquisition and disposal of assets, other than those related to operating activities, are shown under this category.
- In order to calculate cash flow from financing activities inflows and outflows related to the amount of capital and borrowings of the enterprise are shown under this head.