Statement of Changes in Financial Position (SCFP)

12

Financial position refers to "the status of an enterprise as shown by its assets, liabilities and equity as reported in its balance sheet" (Nobes 2002). In general, outside interested parties want financial statements which include Income Statement and Balance Sheet. Both the companies Acts (1913 and 1994) prescribed that "any member of a company shall be entitled to be furnished with copies of the balance-sheet and the Income Statement and the auditor's report" free of any charge. These two financial statements fail to show the financial position changes from year to year. Changes in the financial position over years have become an issue of interest to both internal and external interested parties. This unit has been designed to explain the statements that can answer to the issue. This unit will cover the following lessons:

Fund Flow Statement

Cash Flow Statement & [IAS # and 7]

Value-added Statement

Lesson-1: Fund Flow Statement

After completing this lesson, you are expected to be able to:

- To explain the term "Fund";
- To explain the need of "Fund Flow Analysis";
- To describe the methods of preparing Funds Flow Statement; and
- To compare alternative formats of Funds Flow Statements.

Fund

The word "Fund" means different things to different persons. It is therefore, necessary to be clear on the meaning of word 'Funds'.

Christopher Nobes: The Penguin Dictionary of Accounting:

> "Fund is a pool of resources set aside for particular purposes. For example, a pension fund is a separate legal entity that contains investments and other resources designed to provide payments to pensioners."

This definition is related to a separate type of accounting. Moreover, government accounting is also known as fund accounting.

Jerry M. Rosenberg: The Essential Dictionary of Investing and Finance

Funds: a sum of money or stock convertible to money, assets.

Eric L. Kohler: Koher's Dictionary for Accountants

(i) An asset or group of assets within any organization, separated physically or in the accounts or both from other assets and limited to specific use.

(ii) Cash, securities, or other assets placed in the hands of a trustee, principal or income or both being expended in accordance with the terms of a formal agreement.

(iii) Current assets less current liabilities (on accrual basis): working capital; a term used in flow statements.

(iv) Cash

According to R.N. Anthony – "Funds are the economic values that change hands in business transactions or that exist in the assets of a business."

Thus, there are the following statements:

(a) Cash Flow Statement;

(b) Statement showing working capital changes;

(c) Funds Flow Statement.

These statements show the movement of resources or the changes occurring in the concerned segment (cash, working capital or total resources) between two time bound periods in an enterprise. Thus, a funds flow statement shows the changes in the flow of resources into and outside the enterprise, within a given time period. **Gordon and Shillinglaw** are of the opinion that "analysis of changes in structure .... is the domain of funds flow analysis. By examining the changes in the balance sheet items between balance sheet dates, one many determine the sources of the funds obtained and the ways in which these funds were used during this limited time period."

Thus, financial statements of two time-bound periods i.e. (year 1) and (year 2) can show:

i. The sources and uses of finance for the period 1;
ii. The sources and uses of finance for the period 2; and
iii. The changes in sources and uses of finance between the period 1 and period 2.

Funds- Flow Statement

Eric L. Kohler:

"A statement of funds received and expended; a statement of changes in financial position or statement of sources and applications of funds in which elements of net income and working capital contributing to an understanding of the whole of financial operations during the reporting period replace totals of these items."

Yorston, Smyth and Brown:

"A funds statement is prepared in summary form to indicate changes (and trends if prepared regularly) occurring in items of financial condition between two different balance sheet dates."

Significance of Funds Flow Statement

From balance sheets and income statements, one can draw inference about the financial position of the concern on a specific date. However, an analysis of the changes in the quantity and quality of financial affairs of a concern over the accounting period should be more revealing. This is the precise justification of preparing Fund Flow Statements. Fund flow statements analyse the changes in financial management methods and suggest to improve the quality of the economic health of an enterprise year after year. The three groups of beneficiaries of funds flow statements are:

(a) Managers of the enterprise;
(b) Existing and potential owners of the enterprise, and
(c) Existing and potential creditors.

(a) Managers of the enterprise:

From funds flow analysis, the managers of the enterprise may have the following benefits:

(i) Quantity and quality of resource movement can be known;

(ii) Compliance of laid-down policies regarding financing and portfolio decisions can be known;

(iii) Success of policies laid down and signals regarding corrective actions can also be available;

(iv) Funds flow analysis can act as a "Guide to Future actions" in the following ways:

  (1) Review of cash plans or budgets based on historic and projected funds flow statement;

  (2) Evaluation of feasible alternative sources of finance and uses of finance for the future;

  (3) Forecasting the long-range cash needs and cash availability;

  (4) Estimating the funds available for the capital expansion programs by identifying the surplus funds.

In brief, funds flow analysis aids managers in the function of financial planning and control.

Investors [Existing & Potential]: The funds flow analysis helps the existing and potential investors to appraise the quality of the company's financial health and policies which becomes the basis of the investors' decisions. Moreover, funds flow analysis can thought light on the following issues:

(a) Utilization of funds contributed by investors;

(b) Utilization of different sources of funds and future fund generating capacity of an enterprise;

(c) Implication of funds flow on profitability, dividend policy, payout policy, earning per share, dividend per share and plunge back policy.

Creditors: Creditors are interested in the solvency and liquidity of an enterprise. The funds flow analysis can indicate the present and potential liquidity of an enterprise. Creditors interest in the funds flow statement stems from the need to assess the creditworthiness of an enterprise and its ability to honour the periodic obligations in respect of interest payment and principal repayment. The funds flow statement by revealing the changes in the direction of the flow of resources serve the purpose very well. Projected and historical funds flow statements can guide management action and decisions.

Other Uses of Funds Flow Statement [Perry Mason]:

Funds Flow Statements try to provide useful signals relating to the following:

(a) How were the profits used in business?

(b) What is the justification for the declared dividends?

(c) Why were the dividends not more in spite of increase in the earnings per share?

(d) From where did the enterprise get funds to declare dividends?
 (i) in excess of current year's profits and
 (ii) in spite of a loss in the current year?

(e) What is the justification for raising borrowed funds to support expansion programmes, although the cash flow from within exceeds the required amount.

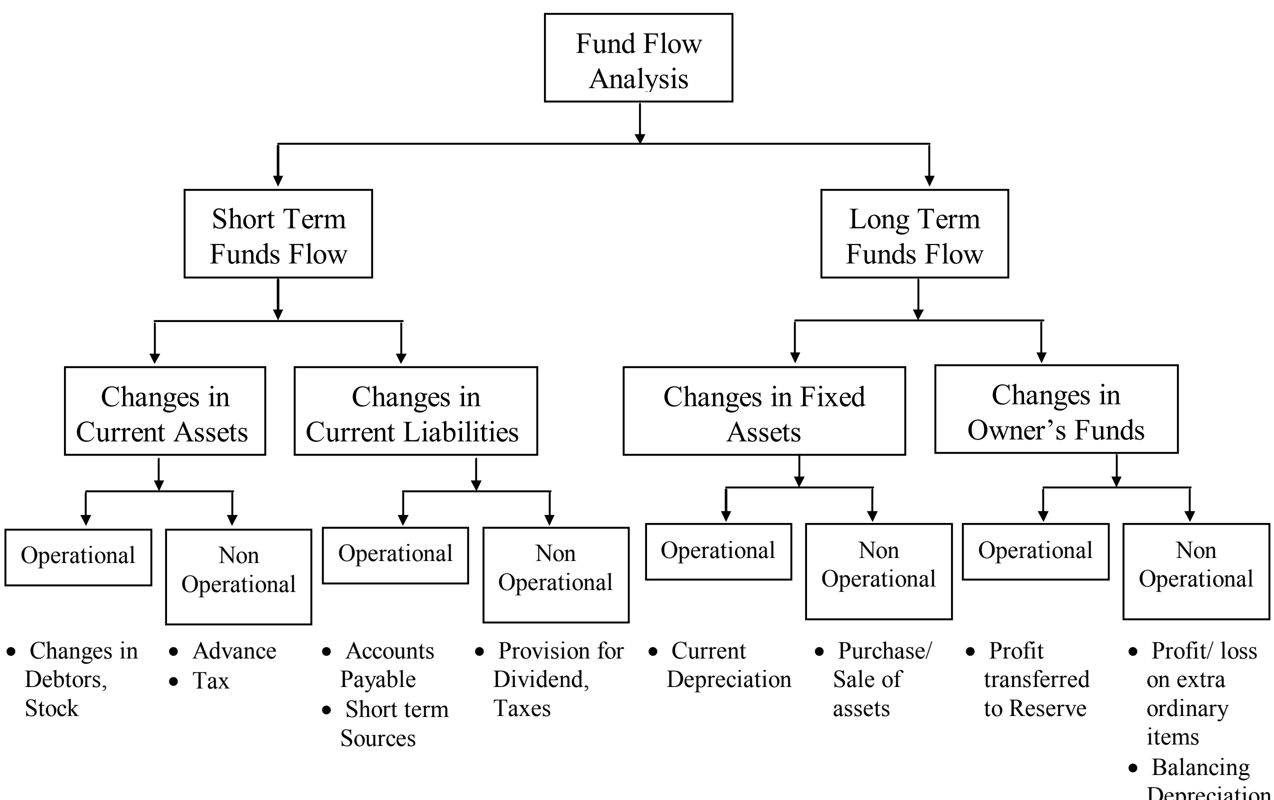
(f) What are the sources of finance to support the purchase of fixed assets?

(g) How was the proceed of the sale of fixed assets disposed?

(h) How was the proceed from the issue of debentures employed and how was the redemption of borrowed capital financed?

(i) How was the enterprise able to meet the additional demands on the working capital?

(j) Why is net working capital moving inversely with the profits of an enterprise?



Construction of the Funds Flow Statement

For preparing Funds Flow Statements the following information are to be reconembered:

(i) Balance sheet at the beginning of the period for which the statement of funds flow will be prepared;

(ii) Balance sheet at the end of the period for which the Funds Flow

Statement will be prepared;

(iii) A summarised income statement or at least material information from that statement, and

(iv) Lastly a condensed statement of retained earnings clarifying fund effects of ownership transactions.

Format of Funds Flow Statement
Niloy & Company Ltd.
Funds Flow Statement
For the Year Ended on December 31, 2006

	Taka
Sources:	
(a) Issue of share capital	
(b) Issue of Debentures	
(c) Institutional loans	
(d) Sale of investments & other fixed assets	
(e) Funds from operations	
(f) Non-trading items .... dividend received total	
Total	
Applications:	
(a) Payment of share capital (Redeemable)	
(b) Repayment of institutional loans	
(c) Redemption of Debentures	
(d) Purchase of investments and other assets	
(e) Non-trading payments .... dividend paid	
Total	
Increase / Decrease in Net Working capital as per Statement of Changes in Net Working Capital	

Format of the Statement of Changes in Net Working Capital:

.... Ltd.
Statement of Changes in Working Capital
For the Year Ended on December 31, 2007

Particulars	Dec 31, 2006	Dec 31, 2007	Changes in Working Capital	
			Increase	Decrease
	Taka	Taka	Taka	Taka
Current Assets:				
Stock				
Debtors				
Cash				
Bank				
Bills Receivable				
Prepaid Expenses				

Total				
Current Liabilities: Creditors Bills Payable Outstanding Expense				
Total				
Net Working Capital Increase / Decrease in Net Working Capital				
Total				

While preparing a schedule of changes in working capital it should be noted that:

(i) (a) An increase in current assets increases working capital;
  (b) A decrease in current assets decreases working capital;
  (c) An increase in current liabilities decreases working capital; and
  (d) A decrease in current liabilities increases working capital

(ii) All the above changes in current assets and current liabilities are combined together to show the change in the period end Net Working Capital from the beginning Net Working Capital

Determination of Funds from Operation:

Among the various sources of funds, it is relatively most difficult to determine the funds from operation. It is a problem, because the "Income Statement" or the Profit & Loss Account is prepared on accrual basis. Therefore, the income figure does not show the net cash inflow. Therefore, this figure should be adjusted to find out the amount of net cash inflow during the period.

(A) The following items charged as expenses in the Income Statement should be added:

(i) Depreciation, Amortization of patents, goodwill;

(ii) Writing off of discount on issues of shares and debentures;

(iii) Writing off of preliminary expenses

(iv) Transfer to reserves

(v) Provision for taxation

(vi) Loss on sale of assets

"All non-funds and / or non-operating debits should be excluded while converting the income data into fund data."

(B) The following items added to income should be deduced to determine funds from operation:

(i) Income from dividend,

(ii) Transfer back of excess provision from taxation,

(iii) Refund of tax

(iv) Rental Income

(v) Profit on sale of assets

Example # 1

From the following balance sheets of Alpha Ltd. make out (i) Statement of Changes in Working Capital and (ii) Funds Flow Statement

Capital & Liabilities	2006 Tk.	2007 Tk.	Assets	2006 Tk.	2007 Tk.
Equity Share Capital	300,000	400,000	Goodwill	100,000	80,000
8% Redeemable Preference share capital	150,000	100,000	Land & Buildings	200,000	170,000
			Plant	80,000	200,000
Capital Reserve	--	20,000	Investment	20,000	30,000
General Reserve	40,000	50,000	Sundry Debtors	140,000	170,000
Profit & Loss Account	30,000	48,000	Stock	77,000	109,000
Proposed Dividend	42,000	50,000	Bills Receivable	20,000	30,000
Sundry Creditors	25,000	47,000	Cash in hand	15,000	10,000
Bills Payable	20,000	16,000	Cash at bank	10,000	8,000
Liability for expenses	30,000	36,000	Preliminary Expenses	15,000	10,000
Provision for taxation	40,000	50,000			
Total	**677,000**	**817,000**	**Total**	**677,000**	**817,000**

Additional information:

(i) A piece of land had been sold out in 2007 and the profit on sale has been credited to capital reserve.

(ii) A machine has been sold for Tk.10,000. The written down value of the machine was Tk.72,000. Depreciation of Tk.10,000 is charged on plant account in 2007.

(iii) The investments are trade investments Tk.3,000 by way of dividend was received including Tk.1,000 pre-acquisition profit which has been credited to Investment Account.

(iv) An interview dividend of Tk.20,000 has been paid in 2007.

Solution:

(i)

Alpha Ltd.
Statement of Changes in Working Capital
During the Year 2007

Particulars	2006	2007	Changes in working

	Tk.	Tk.	capital	
			Increase	Decrease
Current Assets:				
Stock	77,000	1,09,000	32,000	
Sundry Debtors	140,000	1,70,000	30,000	
Bills Receivable	20,000	30,000	10,000	
Cash in hand	15,000	10,000		5,000
Cash at Bank	10,000	8,000		2,000
Total	262,000	327,000		
Current Liabilities:				
Sundry Creditors	25,000	47,000		22,000
Bills Payable	20,000	16,000	4,000	
Liability for expenses	30,000	36,000		6,000
Total	75,000	99,000		
Working Capital	1,87,000	2,28,000		
Increase in Working Capital	41,000			41,000
	228,000	228,000	76,000	76,000

Alpha Ltd.
Statement of Sources and Application of Funds
During the Year 2007

Sources	**Tk.**	**Applications**	**Tk.**
Issue of Equity	100,000	Pref. Shares redeemed	50,000
Sale of Land	50,000	Interim dividend paid	20,000
Sale of a machine	10,000	Purchase of plant	142,000
Dividend Received	3,000	Investment purchased	11,000
Profit from operations	1,43,000	Payment of proposed dividend of 2006	42,000
		Increase in working capital	41,000
	306,000		306,000

Notes:

(i) Funds from operation:

Profit & Loss A/C balance at the end of 2007:		Tk.48,000
Less: Beginning balance:		(30,000)
Dividend received		(2,000)
Add: Proposed Dividend	Tk.50,000	
Provision for taxation	10,000	
General Reserve	10,000	
Loss on sale of a machine	2,000	
Depreciation on plant	10,000	

Goodwill written off	20,000	
Preliminary Exp. written off	5,000	
Interim Dividend	20,000	
		1,27,000
Funds from operation:		Tk.1,43,00 0

(ii) Purchase of plant:	
Beginning balance	Tk.80,000
Less written down balance of plant sold	22,000
	58,000
Add purchase of plant	142,000
Ending balance	Tk.200,00 0
(iii) Investment purchased:	
Beginning balance:	20,000
Ending balance	30,000
	Tk.10,000
Add reduction by capital profit	1,000
Cost of purchase:	Tk.11,000

Example # 2:

The following are the summaries of the Balance Sheet of Time and Talent Limited as at 31st December, 2006 and 31st December 2007.

	2006 (Tk.)	2007 (Tk.)
Sundry Creditors	39,500	41,135
Bills Payable	33,780	11,525
Bank Overdraft	59,510	–
Provision for taxation	40,000	50,000
Reserves	50,000	50,000
Profit & Loss Account	39,690	41,220
Share Capital	200,000	260,000
Total	462,480	453,880
Cash	2,500	2,700
Sundry Debtors	85,175	72,625
Sundry Advances	2,315	735
Stock	111,040	97,370
Land and Building	148,500	144,250
Plant & Machinery	112,950	116,200

Goodwill	–	20,000
Total	462,480	453,880

The following additional information is obtained from the general ledger:

(i) During the year ended 31^{st} December, 2007 an interim dividend of Tk.26,000 was paid.

(ii) The assets of another company were purchased for Tk.60,000 payable in fully paid shares of the company. These assets consisted of stock Tk.21,640, machinery Tk.18,360 and goodwill Tk.20,000. In addition sundry purchases of plant were made totaling Tk.5,650.

(iii) Income tax paid during the year amounted to Tk.25,000.

(iv) The net profit for the year before tax was Tk.62,530.

You are required to prepare a statement showing the sources and applications of Funds for the year 2007 and a schedule setting out changes in working capital.

Solution:

Time & Talent Limited
Schedule of Change in Working Capital
During 2007

Particulars	Dec., 31, 2006 Tk.	Dec. 31 2007 Tk.	Change in Working Capital	
			Increase Tk.	Decrease Tk.
Current Assets				
Cash	2,500	2,700	200	
Debtors	85,175	72,625		12,550
Advances	2,315	735		1,580
Stocks	111,040	97,370		13,670
Total	201,030	173,430		
Current Liabilities				
Sundry Creditors	39,500	41,135		1,635
Bills Payable	33,780	11,525	22,255	
Bank Overdraft	59,510	–	59,510	
Provision for taxation	40,000	50,000		10,000
Total	172,790	102,660		
Net Working capital	28,240	70,770		
Increase in Working capital	42,530			42,530
Total	70,770	70,770	81,965	81,965

Time & Talent Limited
Statement of Sources and Applications of Funds
For the Year Ended December 31, 2007

Sources	Taka	Applications	Taka
Share Capital	60,000	Purchase of Goodwill	20,000
Funds from Operation:		Purchase of Machinery	24,010
Net Profit Tk.62,530		Increase in current assets	42,530
Add Depreciation:		Interim dividend paid	26,000
Plant: 20,760		Provision for taxes	35,000
Building 4,250 25,010	87,540		
	147,540		147,500

Example # 3:

The following Schedule shows the Balance sheets in condensed form of B.C. Limited at the beginning and end of the year:

Particulars	31-12-2006	31-12-2007
Cash	Tk.50,409	Tk.40,535
Sundry Debtors	77,180	73,150
Temporary Investments	110,500	84,000
Prepaid expenses	1,210	1,155
Inventories	92,154	105,538
Cash Surrender values of life investment	4,607	5,353
Land	25,000	25,000
Buildings, Machinery etc.	147,778	182,782
Debenture discount	4,305	2,867
Total Taka	513,143	520,380
Sundry Creditors	103,087	95,656
Outstanding Expenses	12,707	21,663
4% Mortgage Debentures	82,000	68,500
Accumulated Depreciation	96,618	81,633
Allowance for Inventory loss	2,000	8,500
Reserve for contingencies	106,731	134,178
Surplus in P/L account	10,000	10,250

Share Capital	100,000	100,000
Total Taka	513,143	520,380

The following information concerning the transaction is available.

(i) Net profit for 2007 as per profit and loss account was Tk.49,097.

(ii) A 10% cash dividend was paid during the year.

(iii) The premium on life insurance policies was Tk.2,773 of which Tk.1,627 were charged to profit and loss account of the year.

(iv) New machinery was purchased for Tk.31,365 and machinery costing Tk.32,625 was sold during the year. Depreciation on machinery sold had accumulated to Tk.29,105 at the date of sale. It was as scrap for Tk.1,500. The remaining increase in fixed assets resulted from construction of a building.

(v) The mortgage debentures mature at the rate of Tk.5,000 per year. In addition to the above the company purchased and retired Tk.8,500 of the debentures at Tk.103. Both the premium on retirement and the applicable discount were charged to profit and loss account.

(vi) The allowance for inventory loss was created by a charge to expense in each year to provide for obsolete items.

(vii) A debit to reserve for contingencies of Tk.11,400 was made during the year. This was in respect of a past tax liability.

You are required to prepare a statement showing the sources and application of funds for the year 2007.

Solution:

B.C. Limited
Statement of Changes in Working Capital
During the Year 2007

Particulars	31 Dec. 2006	31 Dec. 2007	Change in Working Capital	
			Increase	Decrease
Current Assets:	Tk.	Tk.	Tk.	Tk.
Cash	50,409	40,535		9,874
Sundry Debtors	77,180	73,150		4,030
T. Investments	110,500	84,000		26,500
Prepaid Expenses	1,210	1,155		55
Inventories	92,154	105,538	13,384	13,670
Total	331,453	304,378		
Current Liabilities				
Sundry Creditors	103,087	95,656	7,431	
Outstanding Expenses	12,707	21,663		8,956
	115,794	117,319		

Net Working Capital	215,659	187,059		
Decrease in working capital		28,600	28,600	
	215,659	215,659	49,415	49,415

B.C. Ltd.
Statement of Sources and Applications of Funds
For the Year Ended December 31, 2006

Sources	**Tk.**
Sale of machinery	1,500
Trading Profit:	
(Tk.250+10,000+38,847+1,627+2,020+255+ 6,500+1,438+14,120+400)	75,457
Total	76,957
Applications	
Purchase of new machinery	31,365
Building construction	36,264
Redemption of Debenture	13,755
Dividend paid	10,000
Premium on life policy	2,773
Tax liability	11,400
	1,05,557
Decrease in Net working capital	28,600
	76,957

Example # 4

The directors of the C Ltd. present you with the balance sheets as on June 30, 2006 and 2007 and ask you to prepare statements which will show them what has happened to the money which has come into the business during the year:

Liabilities	30-6-06	30-6-07	Assets	30-6-06	30-6-07
Authorized Caital:15,000 shares of Tk.100 each	15,00,000	15,00,000	Freehold Building	800,000	11,76,000
Paid up Capital	13,00,000	14,00,000	Plant & Machinery	144,000	3,94,000
General Reserves	60,000	40,000	Fixture & Fittings	6,000	5,500
Profit & Loss Appropriation	36,000	38,000	Cash in hand	1,560	1,280
Provision for purpose of final dividends	78,000	72,000	Sundry debtors	125,600	1,04,400
Sundry Creditors	76,000	1,12,000	Bills Receivable	7,600	6,400
Bank Overdraft	69,260	1,29,780	Stock	244,000	238,000

Bills Payable	40,000	38,000	Pre-payments	4,500	6,200
Loans on Mortgage	–	5,60,000	Shares in other companies	80,000	234,000
			Goodwill	240,000	220,000
			Preliminary expenses	6,000	4,000
	16,59,260	23,89,780		16,59,260	23,89,780

You are given the following additional information for 2006-07:

(a) Depreciation has been charged.

(i) On Freehold building @ 2.5% per annum on cost of Tk.10,00,000;

(ii) On plant and Machinery @ 8% on cost of Tk.400,000;

(iii) On Fixture and Fittings @ 5% on cost of Tk.10,000.

No depreciation has been written off newly acquired building, plant and machinery.

(b) Shares in other companies were purchased and dividends amounting to Tk.6,000 declared out of profits made prior to purchase has been received and used to write down the investment (shares)

(c) Goodwill has been written down against general reserves.

(d) The proposed dividends for the year 2006 was paid and in addition, an interim dividend Tk.52,000 was paid.

Solution:

C. Limited
Schedule of Changes in Working Capital
For the Year Ended June 30, 2007

Particulars	30 June 2006	30 June 2007	Change in Working Capital	
			Increase	Decrease
Current Assets:	Tk.	Tk.	Tk.	Tk.
Cash in hand	1,560	1,280		280
Sundry Debtors	1,25,600	1,04,400		21,200
Bills Receivable	7,600	6,400		1,200
Stock	244,000	2,38,000		6,000
Prepayments	4,500	6,200	1,700	
Total	3,83,260	3,56,280		
Current Liabilities:				
Sundry Creditors	76,000	1,12,000		36,000
Bank Overdraft	69,260	1,29,780		60,520

Bills Payable	40,000	38,000	2,000	
Total	1,85,260	2,79,780		
Net Working Capital	1,98,000	76,500		
Decrease in Working Capital		1,21,500	1,21,500	
Total	1,98,000	1,98,000	125,200	125,200

C. Ltd.
Statement of Sources and Applications of Funds
For the Year Ended 30th June, 2007

			Tk.
Sources of Funds			
Share Capital			1,00,000
Mortgage			5,60,000
Dividend received			6,000
Funds from Operations:			
Balance (net)		Tk.2,000	
Dividend paid [72,000+52,000]		124,000	
Depreciation charged:			
Freehold Building	25,000		
Plant & Machinery	32,000		
Fixture & Fittings	500	57,500	
Preliminary Expenses		2,000	1,85,500
Total			8,51,500
Application of Funds:			
Purchase of buildings			4,01,000
Purchase of plant and machinery			2,82,000
Purchase of new shares			1,60,000
Dividends [78,000 + 52,000]			1,30,000
			9,73,000
Decrease in Net Working Capital			1,21,500

Example # 5

The balance sheet of Wong Ltd. as on December 31, 2006 was as follows:

Liabilities	Tk.	Assets		Tk.
6% Redeemable preference share capital (filly paid shares of Tk.100 each)	200,000	Land and building Plant & Machinery Patents		200,000 680,000 100,000
Equity share capital (fully paid shares of Tk.100 each)	500,000	Trade Investments Investments, in Govt. Securities as		250,000
Capital redemption reserve account	100,000	current assets Stock in trade		70,000 120,000
Revenue reserve & surplus	250,000	Book Debts	170,000	
7% Debentures	250,000	Less Provision		
Liabilities for gods & service Provisions for income tax	170,000 180,000	for Bad Debt Cash	10,000	160,000 110,000
Proposed equity dividend	50,000	Preliminary expenses		10,000
Total	17,00,000	Total		17,00,000

The company has prepared the following projected profit and loss account for 2007:

Dr.			**Cr.**
Particulars	**Taka**	**Particulars**	**Taka**
Opening Stock	1,20,000	Sales	24,00,000
Purchases	15,00,000	Closing Stock	1,80,000
Wages	2,60,000	Income from trade investments	9,000
Salaries and other expenses	2,80,000	Profit on sales of machinery	6,000
Provision for depreciation Provision for income tax	97,000 1,90,000	Saving in provision for income tax for 2006	15,000
Preference dividend	12,000		
Proposed equity dividend	60,000		
Preliminary expenses	5,000		
Balance of profit	86,000		
	26,10,000		26,10,000

You are given the under mentioned further information:

(i) Provision for depreciation as on December 31, 2006 was 2,30,000 against plant and machinery and Tk.20,000 against land and buildings of the amount provided against depreciation in 2007 Tk.5000 will be for land and buildings.

(ii) At the end of 2007, the redeemable preference shares are to be redeemed.

(iii) New machinery Tk.150,000 will be installed towards the end of 2007.

(iv) The company allows one month's credit to its customers and receives 1.5 months credit from its suppliers. Wages, salaries and other expenses are paid one month in arrear.

Prepare the balance sheet of the company as it is likely to be on December 31, 2007 and also a statement showing sources and applications of funds during the year. Assume that to the extent necessary government securities will be sold at book value and bank overdraft will not be raised.

Solution:

Wong Ltd.
Projected Balance Sheet
As on December 31, 2007

Liabilities & Capital	Taka	Assets		Taka
Equity share: (Fully paid shares of Tk.100 each)	500,000	Land & Building Plant & Machinery		195,000 728,000
Capital Redemption Reserve	300,000	Patents		100,000
Revenue Reserve & Surplus	136,000	Trade Investments		250,000
7% Debentures	250,000	Investment in Govt. Securities as current assets		20,500
Liabilities for goods & service	232,500	Stock-in trade		180,000
Provision for taxation	190,000	Book Debts:	200,000	
Proposed Dividends	60,000	Less Provision	10,000	190,000
		Cash		–
		Preliminary expenses		5,000
	16,68,500			**16,68,500**

Cash A/C

	Taka		Taka
Balance	1,10,000	Payment to suppliers	14,82,500
Collection from debtors	23,70,000	Salaries & Wages	4,95,000
Sale of machine	16,000	Redemption of Shares	2,00,000
Income from trade investment	9,000	Purchase of machine	1,50,000
Sale of Govt. Securities	49,500	Pref. dividend paid	12,000
		Income tax paid	1,65,000
		Equity divided paid	50,000
	2554,500		**25,54,500**

Wong Ltd.
Schedule of Changes in Net Working Capital
For the Year Ended December 31, 2007

Particulars	31st Dec. 2006	31st Dec. 2007	Changes in Working Capital	
			Increase	Decrease
Current Assets:	Tk.	Tk.	Tk.	Tk.
Cash	110,000	–		110,000
Trade Investments	250,000	250,000		–

Govt. Securities	70,000	20,500		49,500
Stock-in trade	120,000	180,000	60,000	
Book Debt	160,000	190,000	30,000	
Total	600,000	640,000		
Current Liabilities				
Liabilities for Goods & Services	170,000	232,500		62,500
Provisions for income tax	180,000	190,000		10,000
Total	350,000	422,500		
Net Working capital	250,000	218,000		
Decrease in Net Working Capital		32,000	142,000	
Total	250,000	250,000	232,000	232,000

Wong Ltd.
Expected Sources and Applications of Funds
For the Year Ended 31st December, 2007

Sources		Tk.
Sale of a machine		16,000
Flow from operation:		
Profit balance	Tk.86,000	
Add: Proposed Equity divided	60,000	
Proposed Pref. divided	12,000	
Planet expenses	5,000	
Depreciation	97,000	
	260,000	
Less Profit on sale	6,000	254,000
Total		270,000
Applications:		
Purchase of machines		150,000
Redemption Shares		200,000
Dividend paid (50,000 + 12,000)		62,000
		412,000
Decrease in Working Capital		142,000

Example # 6

Given below are the condensed Balance Sheets, Income Statement and Statement of reconciliation of Retained Earnings of ABC Ltd.

Balance Sheet

(000 omitted)

	Dec.31, 2007		Dec. 31,2006	
Assets:	Tk.	Tk.	Tk.	Tk.
Fixed Assets:				
Land		1,548		1,554
Plant	65,070		57,622	
Less Depreciation	36,484	28,586	34,048	23,574
Transportation Properties	11676		10858	
Less Depreciation	4,778		4,560	
		6,898		6,298
Current Assets:				
Cash		4,298		4,668
Receivables less bad debts		5,274		5,056
Inventories		8,494		7,996
Prepaid expenses		1,562		1,496
Investments		3108		12,168
Total		59,768		62,810
Liabilities & Capital:				
Capital:				
7% Pref. Share Capital				
(Share of Tk.100 each)		7,206		7,206
Equity Capital				
(Share of Tk.1 each)		17,406		17,406
Retained Earnings		20,350		19,546
Fixed Liabilities:				
Long Term debt		1,220		1,098
Current Liabilities:				
Accounts Payable		7,506		6,794
Unpaid Taxes		5,500		10,194
Dividend Payable		518		518
Long-term debt due within				
one year:		62		48
Total		59,768		62,810

ABC Ltd.
Income Statement
For the Year End December 31, 2006
(000 omitted)

Tk.

Sales		62,746
Less cost of sales		45,782
Gross Profit		16,964
Less Expenses:		
Selling, General & Administration*	10,440	
Interest	38	
Taxes	1,364	11,842
Net Operating profit before income tax		5,122
Add: Profit from sale of fixed assets		92
Net profit before income tax		5,214
Less Estimated income tax		2,340
Net income		2,874

* Includes depreciation for the year Tk.3,630

Statement of Reconciliation of Retained Earnings
For the Year Ending 31st December, 2007
(000 omitted)

		Tk.
Retained Earnings (1-1-2007)		19,546
Net Income for the year		2,874
Total		22,420
Less Dividends paid:	Tk.	
Preference	504	
Equity	1,566	2,070
Retained Earnings (31-12-07)		Tk.20,350

Further information:

(i) Assets with the gross book values (i.e. before deduction for depreciation shown below were disposed of during 2007.)

Land Tk.24; plant Tk.924; Transportation properties Tk.176.

Depreciation on these assets had been accumulated as given below:

Plant Tk.820; Transportation Properties Tk.156.

The land was sold for its book value of Tk.24. The sale of other fixed assets resulted in additional proceeds of Tk.216, this was Tk.92 more than their book value.

(2) Fixed assets totaling Tk.9,384 were acquired during the year but the break up of this figure among the three categories of fixed assets is not known.

You are required to prepare a statement of changes in working capital and a statement of sources and applications of funds.

Solution:

ABC Ltd.
Statement of Changes in Working Capital

[Tk.'000]

Particulars	31st Dec. 2006	31st Dec. 2007	Change in Working Capital	
			Increase	Decrease
Current Assets:	Tk.	Tk.	Tk.	Tk.
Cash	4,668	4,298	–	370
Receivables	5,056	5,274	218	–
Inventories	7,996	8,494	498	–
Prepaid expenses	1,496	1,562	66	–
Investments	12,168	3,108		9060
Total	31,384	22,736		
Current Liabilities:				
Accounts payable	6,794	7,506		712
Unpaid taxes	10,194	5,500	4694	–
Dividend payable	518	518	–	–
Long-term debt: Current liabilities	48	62		14
Total	17,558	13,586		
Net Working Capital	13,830	9,150		
Decrease in Net working capital		4,680	4680	
Total	13,830	13,830	10,156	10,156

ABC Ltd.
Statement of Sources and Applications of Funds
For the Year Ended on December 31, 2007

['000]

Sources:		Tk.
Long-term Loans:		122
Sale of land		24
Sale of other assets		216
Funds from operation:		6,412
Net Profit:	2,874	
Less Profit on sale	92	
	2,782	
Plus Depreciation	3,630	

	6,412	
		6,774
Applications:		
Purchase of land		18
Purchase of fixed assets		9,366
Dividend paid:		
Preference	504	
Equity	1,566	2,070
		11,454
Decrease in Net Working Capital		4,680

Lesson-2: Cash Flow Statement

After completing this lesson, you are expected to be able to:

- Describe the limitations of Funds Flow Statement.
- Explain the concept of Cash Flow Statement.
- Explain the objectives & benefits of Cash Flow Statement.
- Differentiate between Funds Flow Statement and Cash Flow Statement.
- Illustrate provisions of IAS # 7 relating to Cash Flow Statement.
- Present the Cash Flow Statement in different methods.

Introduction

An analysis of the history of corporate financial reporting in Bangladesh shows that at the beginning of the corporate external reporting culture under the Companies Act 1913, companies were required to publish "Profit and Loss Account" and "Balance Sheet". Later on, during sixties companies started publishing agencies required companies to publish "Cash Flow Statement". Naturally, it will be of interest to "Cash Flow Statement." This might have happened owing to: (i) changes in the international scene and (ii) limitations of the Fund Flow Statement.

In 1977 the International Accounting Standards Committee issued IAS # 7 which required enterprises to prepare the statement of changes in financial position, commonly referred to as the Funds Flow Statement, as an integral part of financial reporting process. But in 1992, the IASC issued a revised IAS 7, Cash Flow Statements and made it effective for financial statements of period beginning on or after January 1, 1994. This particular change in IAS # 7, might have caused the change in this respect in Bangladesh. At this point, it is natural to raise questions about the causes of transmission from "Funds Flow Statement" to "Cash Flow Statement". The answer is simple that Funds Flow Statements failed to serve the needs of users of financial statements. It is claimed that Funds Flow Statements can help the users in the following ways:

(a) Evaluating the uses of funds by the enterprise;

(b) Determining how these uses are financed;

(c) Providing an insight into the financial operations of a business enterprise;

(d) Evaluating the financing pattern of the enterprise; and

(e) Serving as a control device.

Although a Funds Flow Statement has many advantage as mentioned above yet it has some limitations also. These are:

(i) Funds Flow Statements are not easily understandtable to external users, because the term "Fund" has various ....

(ii) As a Funds Flow Statement is prepared based on the balance sheets of two different dates; it has very limited explanation of the operating activities of an enterprise.

(iii) It fails to measure the ability to generate future positive cash flows;

(iv) It fails to measure the ability to meet obligations and pay dividends;

(v) It fails to identify reasons for differences between income and cash receipts and payments; and

(vi) It fails to segregate properly cash and non-cash aspects of enterprises "Investing"; "Financing" and "Operating" transactions.

Cash Flow Statement: [E. L. Kohler]

"A statement of cash (inflow) income and outgo between two given dates, its components often identified with items operating in balance sheets and intervening income statements .... Cash-flow statements are often regarded by security and credit analysts as providing a better basis for judgments concerning profits, financial conditions and financial management than the basis supplied by traditional but now often compromised income statements, one common derivatives from cash flow statements often cited by analysts has been growth trends."

Differences between a Cash Flow Statement and a Funds Flow Statement": [S. K. Chakrobarty]

(i) Cash flow statement considers the cash inflows and outflows only. Funds flow statement shows net changes in current assets and current liabilities. Thus one ends with changes in cash balance and the other ends with changes in net working capital.

(ii) A Cash Flow Statement is prepared on the basis of balance sheet and profit & loss account, whereas a Funds Flow Statement is prepared on the basis of balance sheet only.

(iii) Cash Flow Statement indicates increase in gross fixed assets whereas funds flow statement indicates the net increase after deducting depreciation.

(iv) Cash Flow Statement prepared on the basis of forecast is a forerunner of a cash budget.

Objectives of a Cash Flow Statement:

Information relating to objectives of cash flow statements is available in GAAP (U.S); FASB (U. S) and IAS. A comparison of all these sources is given below:

	GAAP (U.S)	FASB (U.S.)	IAS
	To provide information about cash receipts and cash payments of an entity during a period	To provide relevant information about the cash receipts and cash payments of an enterprise during a period	To provide information about cash receipts and cash payments of an entity during a period
	To provide information about the investing and financing activities during the period		To provide insight into the investing and financing activities of the enterprise
	Showed help investors and creditors assess: (i) The ability to generate future positive cash flow. (ii) The ability to meet obligations and pay dividends. (iii) Reason for the difference between net income and cash receipts and payments. (iv) Both cash and no-cash aspects of entities investing and financing transactions.	Help investors, creditors and others to assess: (i) The enterprises ability to generate positive future net cash flow. (ii) The enterprises ability to meet its obligation, its ability to pay divided and its need for external financing. (iii) The reasons for differences between net income and associated cash receipts and payments. (iv) The effects on an entity financial position of both its cash and non-cash invest.	Help investors and creditors assess: (i) The ability to generate future positive cash flows. (ii) The ability to meet obligations and pay dividends. (iii) Reasons for differences between income and cash receipts and payments. (iv) Both cash and non-cash aspects of entities investing and financing transactions.

Uses of the Statement of Changes in Financial Position

Commonly used statements of changes in financial position are (i) Funds Flow Statement (already covered in lesson 1) and the Statement of Cash

Flow. The Cash Flow Statement is now regarded as an important part of financial reporting by companies. In Bangladesh it is now mandatory for listed companies to include cash flow statement in their annual reports.

Cash Flow Statement has an analytical value as well as it is an important planning tool. It gives a clear picture of the causes of changes in the company's cash position. It indicates the financing and investment policies followed by the company in the past. The statement reveals the non-current assets acquired by the company and the manner in which they have been financed from the internal and external sources. **Woelfel, C. J.** in his book- Accounting: An Introduction claims that this statement help answering the following questions:

(i) What is the liquidity position of the firm?

(ii) What are the causes of changes in the firm's working capital or cash position?

(iii) What fixed assets are acquired by the firm?

(iv) Did the firm pay dividends or not? If not, was it due to shortage of funds?

(v) How much of the firms' working capital needs were met by the funds generated from current operations?

(vi) Did the firm use external sources of finance to meet its needs of funds?

(vii) If the external financing was used, what ratios of debt and equity were maintained?

(viii) Did the company sell any of its non-current assets? If so, what were the proceeds from such

(ix) Could the firm pay its long term debt as per schedule?

(x) What were the significant investment and financing activities of the firm that did not involve working capital?

Benefits of Cash Flow Statements [Epstein & Mirza]

Today, the clear consensus of national and international accordingly standard setters is that the statement of cash flows is a necessary component of complete financial reporting. The perceived benefits of presenting the statement of cash flows in conjunction with the statement of financial position (balance sheet) and the statement of income (or operations) have been highlighted by IAS 7 to be as follows:

(1) It provides an insight into the financial structure of the enterprise (including its liquidity and solvency) and its ability to affect the amounts and timing of cash flows in order to adopt to changing circumstances and opportunities.

(2) It provides additional information to the users of financial statements for evaluating changes in assets, liabilities and equity of an enterprise.

(3) It enhances the comparability of reporting of operating performance by different enterprises because it eliminates the effects of using different accounting treatments for the same transactions and events.

(4) It serves an indicator of the amount timing and certainty of future cash flows. Furthermore, if an enterprise has a system in place to project its future cash flows, the statement of cash flows could be used as a touchstone to evaluate the accuracy of past projections of those future cash flows. This benefit is elucidated by the IAS 7 as follows:

   (a) The statement of cash flows is useful in comparing past assessments of future cash flows against current years cash flow information.

   (b) It is of value in appraising the relationship between profitability and net cash flows and in assessing the impact of changing prices.

Definition of Terms

Cash:

Kohler: Money, negotiable money orders and cheques and balances or deposits with banks after deducting outstanding cheques.

IAS#7: Cash comprises cash on hand and demand deposits.

Cash Equivalent:

Kohler: Money's worth, the immediately realizable value of a good or service received in an exchange.

IAS#7 : Cash equivalents are short term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash Flow:

Kohler: The net cash generated by a firm's operations for a given time period, that is, cash inflows from collections of revenue minus cash outflows for payments of expenses. In security analysis, a popular but some what cruder, concept of "cash flow" is net income with non-fund charges, such as depreciation, added back.

IAS#7: Cash flows are inflows and outflows of cash and cash equivalents.

Operating Activities:

GAAP (U.S.A) : The transactions not classified as financing or investing activities, generally involving producing and delivering goods or providing services.

IAS # 7: Operating activities are the principle revenue producing activities of the enterprise and other activities that are not investing or financing activities.

Investing Activities:

GAAP (U.S.A): The transactions the firm engages in which affect their investment in non-current assets (e.g. purchase or sale of plant, property and equipment).

IAS # 7: Investing activities are the acquisition and disposal of long term assets and investment not included in cash equivalents.

Financing Activities:

GAAP (U.S.A): The transactions of a firm engages in to acquire and repay capital (e. g., borrowings, sale of capital stock, repayment etc.)

IAS # 7: Financing activities are activities that result in changes in the size and composition of the equity capital and borrowings of the enterprise.

Direct Method:

GAAP: A method which derives the net cash provided by operating activities from the components of operating cash receipts and payments as opposed to adjusting net income for items not affecting cash.

Indirect Method:

GAAP: A method which derives the net cash provided by operating activities by adjusting net income for revenue and expenses items not resulting from cash transactions.

Cash Focus:

The statement of cash flows includes only inflows and outflows of cash and cash equivalents. On the other hand, it excludes all transactions that do not directly affect cash receipts and payments. However, IAS # 7 requires that the effects of transactions not resulting in receipts or payments of cash be disclosed elsewhere in the financial statement. The reason for this is that it preserves the statements primary focus on cash flows from operating, investing and financing activities. Thus, if a transaction is part cash and part non-cash, only the cash portion is reported in the statement of cash flows.

Gross vs. Net basis:

On the issue of reporting cash receipts and payments on "Gross" or "net" basis IAS # 7 conforms with FASB and U.S. GAAP.

IAS # 7

An enterprise should report separately major classes of cash receipts and gross cash payments arising from investing and financing activities.

Cash flows from the following operating investing or financing activities may be reported on a net basis:

(a) Cash receipts and payments on behalf of customers when the cash flow reflect the activities of customers rather than those of the enterprise; and

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

FASB:

Generally, information about the gross amounts of cash receipts and cash payments during a period is more relevant than information about the net amount of cash receipts and payments. But net amounts may be used in cases where (i) net amounts provide sufficient information and (ii) the turnover is quick, the amounts are large and maturities are short.

GAAP (U.S):

The emphasis in the statement of cash flows is on gross cash receipts and cash payments. In a few circumstances netting of cash flows is allowed. Items having quick turnovers, large amounts and short maturities may be presented as net cash flows if cash receipts and payments pertain to (i) investments other than cash equivalents (ii) loans receivable and (iii) debts (original

Classification of Cash Receipts and Cash Payments

IAS # 7 requires that the cash flow statement should report cash flows during the period classified by operating investing and financing activities. An enterprise presents its cash flows from operating, investment and financing activities in a manner which is most appropriate to its business. Classification by activity provides information that allows users:

(a) to assess the impact of those activities on the financial position of the enterprise and the amount of its cash and cash equivalent;

(b) to evaluate the relationship among those activities.

U. S. GAAP differs form the IAS and U. S. GAAP on the issue of classification of cash flows. IAS and U. S. GAAP are in favor of three classes, whereas, U.K. GAAP started with 5 classes. The revised U. K. standard on cash flow reporting requires classification in eight categories.

(i) Operating activities (ii) Returns on investments and servicing of finance (iii) Taxation (iv) Capital expenditure and financial investment (v) Acquisition and disposal (vi) Equity dividend paid (vii) Management of liquid assets and (viii) Financing.

Companies operating in Bangladesh should follow the cash flow classification by the IAS # 7. There are controversies about the items included in each category of cash flows.

Cash Flows form Investing Activities:

According to FAS 95 (FASB) investing activities include making and collecting loans and acquiring and disposing of debt or equity investments and properly, plant and held for or used in the production of goods or services by the enterprise (other than materials that are part of the enterprises inventory). Items to be included under the head investing activities are given in the chart below suggestions of IAS # 7 must be followed in Bangladesh.

FASB (U.S.A)	GAAP (U.S.A)	IAS # 7
Cash inflows	**Cash inflows**	**Cash inflows**
a. Receipts form collection or sale of loans made by the enterprises and of other enterprises debt instruments other than cash equivalents and certain debt instruments that are acquired specifically for resale that were purchased by the enterprise.	a. Principles collections from loans and sale of other entity's debt instruments.	a) Cash receipts from sale of equity or debt instruments of other enterprises and interest in joint ventures (other than receipts from those instruments considered to be cash equivalents and those held for dealing or trading purposes)
b. Receipts from sales of equity instruments of other enterprise other than certain equity instruments carried in a grading account and from returns of investment in those instruments.	b. Sale of equity instruments of other enterprises and from returns of investment in those instrument.	b) Cash receipts from the repayment of advances and loan made to other parties other than advances and loans of a financial instruments.
	c. Sale of plant &	c) Cash receipts form sales of properties, plant and equipment, intangibles and other

c. Receipts from sales of property, plant and equipment and other productive assets.	equipment.	long term assets. d) Cash receipts from future contracts, forward contract, option contracts and swap contracts, expert when the contracts are held for dealing or trading purposes or the receipts are classified as financing activities.
<u>Cash outflows</u> a. Disbursements for loans made by the enterprise and payments to acquire debt instruments of other entities other than cash equivalents and certain debt instruments that are acquired specifically for resale. b. Payments to acquire equity instruments of other enterprises instruments carried in a grading account. c. Payments at the time of purchase soon before or after purchase acquire properly, plant and equipment and other productive assets	**<u>Cash outflows</u>** a. Loans made and acquisition of other entities debt instruments. b. Purchase of equity instruments of other enterprises. c. Purchase of plant and equipment.	**<u>Cash flows</u>** a) Cash payments to acquire equity or debt instruments other enterprises and instrument in joint venture other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purpose. b) Cash advances and loans made to other parties other than advances and loan made by a financial institution. c) Cash payments to acquire property, plant and equipment intangibles and other long term assets. These payment includes those relating to capitalized development cost and self constructed property, plant and equipment d. Cash payments for futures contracts, forward contract, option contracts except when the contracts are held for dealing or trading purposes or the payments are classified as financing activities.

Compared to requirement of U.S. GAAP, the requirements of IAS # 7 are more elaborate and inclusive.

Cash flow from Financing Activities:

Financing activities include obtaining resources from owners and providing them with a return on and a return of their investment [FASB], receiving restricted resources that by donor stipulation must be used for long-term purposes; borrowing money and repaying amount borrowed or otherwise settling obligations and obtaining and paying for other resources obtained from creditors on long term credit. Items to be included in this category is shown in the following chart.

FASB (U.S.A)	GAAP (U.S.A)	IAS # 7
Cash inflows	**Cash inflows**	**Cash inflows**
a. Proceeds from issuing equity instruments. b. Proceeds from issuing bonds, mortgage, notes and from other short and long term borrowings. c. Receipts from contribution and instrument income at by the donor stipulation are restricted for the purpose of acquiring, constructing or improving property, plant, equipment or their long-lived asset or establishing or improving a permanent endowment or term endowment.	a) Proceeds from issue of stock. b) Proceeds from issue of debt (short-term or long-term). c) Not for profit donor restricted cash gift that are limited to long term purpose.	a) Cash proceeds from issuing shares or other equity instruments. b) Cash proceeds from issuing debentures, loans, notes, bonds, mortgage and other short-term and long-term borrowings.
Cash outflows	**Cash outflows**	**Cash outflows**
a. Payments of dividend or other distributions to owners, including outlays reacquire the enterprises amity instruments. b. Repayments of amounts borrowed. c. Other principal payments to creditors who have extended long term credit.	a. Payment of dividends b. Repurchase of entity's stock c. Repayment of debt principal, including capital lease obligations.	a) Cash payments to owners to acquire or redeem the enterprises shares. b) Cash payments of amounts borrowed. c) Cash payments by a lease for the reduction of the outstanding liability relating to a finance lease.

IAS # 7 advocates the separate disclosure of cash flows arising from financing activities because it is useful in predicting claims on future cash flows by providers of capital to the enterprise. IAS#7 specifies alternative treatments for interest paid and interest and dividends received.

Cash flows from interest and dividends received and paid should each be disclosed separately. Each should be classified in a consistent manner from period to period as operating, investing or financing activities.

Interest paid and 'Interest & Dividend' received:

Financial Institutions: As cash flow from operating activities

Other enterprises:

Alternative # 1: As cash flow from operating activities.

Alternative # 2: Interest paid: As cash flow from financing activities.

Interest & dividend received: As cash flow from investing activities.

Cash Flow from operating activities:

Both FASB and U.S. GAAP gave an exclusive definition of operating activities. According to these two operating activities include all transactions and other events that are not defined as investing or financing activities. But IAS # 7 is more definite in explaining the term "Operating Activities". As already mentioned, operating activities are the principal revenue producing activities of the enterprise and other activities that are not investing or financing activities. According to E. L. Kohler "Operating pertains" to any usual type of activity in which an organization engages". Transactions that should be normally included as operating activities are shown in the table given below.

Operating activities include all transactions and other events that ar not defined as investing or financi

FASB	U. S. GAAP	IAS # 7
<u>Cash inflows</u> a. Cash receipts from sale of goods or services including receipts from collection or sale of accounts and both short-and long-term notes receivable from customers arising from those sales. b. Cash receipts from return on loans, other debt instruments of other entities and equity securities-interest and dividends. c. All other cash receipts that do not stem from	**<u>Cash inflows</u>** a. Receipts from sale of goods and services. b. Sale of loans, debt or equity instruments carried in trading portfolio. c. Returns on loans. (interest) d. Returns on equity securities (dividends).	**<u>Cash inflows</u>** a. Cash receipts from the sale of goods and the rendering of services. b. Cash receipts from royalties, fees, commissions and other revenues. c. Cash receipts of an insurance enterprise for premiums. d. Cash receipts from contract held for dealing or trading purposes. e. Refund of income taxes.

transactions defined as investing or financing activities such as: (i) amounts received to settle law suits. (ii) Proceeds of insurance settlement except those that are directly related to investing or financing activities.		
Cash outflows	**Cash outflows**	**Cash outflows**
a. Cash payments to acquire materials for manufacture or goods for resale. b. Cash payments to other suppliers and employees for other goods and services. c. Cash payments to government for taxes, duties, fines and other fees or penalties. d. Cash payment to lenders and other creditors for interest. e. All other cash payments that do not stem from transactions defined as investing or financing activities.	a. Payments for inventory. b. Payments to employees and other suppliers. c. Payment of taxes. d. Payments of interest e. Purchase of loans, debt or equity instruments carried in trading portfolio. f. Payment of asset retirement obligation.	a. Cash payment to suppliers for goods and services. b. Cash payments to and on behalf of employees. c. Cash payments of taxes unless they can be specifically identified with financing and investing activities.

Content and Form of Statement of Cash Flows

FASB demands that a statement of cash flows for a period shall report net cash provided or used by operating, investing, and financing activities and the net effect of those flows on cash and cash equivalents during the period in a manner that reconciles beginning and ending cash and cash equivalents. A pro-forma of a statement of Cash Flows is given below:

Liquid Corporation
Statement of Cash Flows
For the Year Ended December 31, 2007

Net cash flows from operating activities		$××××××
Cash flows from investing activities:		
Purchase of property, plant and equipment	$(××××)	
Sale of equipment	×××	
Collection of notes receivable	×××	

Net cash used in investing activities		(××××)
Cash flows from financing activities:		
Sale of ordinary shares	××××	
Repayment of long-term debt	(××××)	
Reduction of notes payable	(××××)	
Net cash provided by financing activities		××××
Net cash increase		$××××
Cash and cash equivalent at beginning of year		××××
Cash and cash equivalent at end of year		$××××

Non-cash investing and financing activities should according to IAS # 7, be disclosed in the footnotes to financial statements, but apparently are not intended to be included in the cash flow statement itself. Non-cash financing and investing activities might include:

(a) Acquiring an asset through a finance lease;

(b) Conversion of debt to equity,

(c) Exchange of non-cash assets or liabilities for other non-cash assets or liabilities;

(d) Issuance of ordinary shares to acquire assets.

Methods of Determining Net Cash Flow from Operating Activities

IAS # 7 allows an enterprise to report cash flows from operating activities using either the direct method or the indirect method.

Direct Method:

Under the direct method, the income statement is reconstructed on a cash basis from top to bottom. Under the direct method, the cash receipts and cash disbursements that are related to operations are reconstructed. The difference between the cash receipts and cash disbursements is the net cash provided by operating activities for the period. In this respect, IASC, FASB and UK GAAP encourage the determination of net cash flows from operating activities by using the direct method.

Under the direct method, the cash receipts and cash disbursements that are related to operations are reconstructed.

Entities using the direct method are required by IAS # 7 to report the following major classes of gross cash receipts and cash payments.

(i) Cash collected from customers
(ii) Interest and dividend received
(iii) Cash paid to employees and other suppliers
(iv) Interest paid
(v) Income taxes paid
(vi) Other operating cash receipts and payments.

Formulas for conversion of various income statement amounts for the direct method presentation from the accrual basis to the cash basis are summarized below:

Accrual Basis	Additions	Deductions	Cash Basis
Net Sales	+ Beginning accounts receivable	– Ending accounts receivable – Accounts written off	= Cash received from customers
Cost of Goods sold	+ Ending inventory + Beginning accounts payable	– Manufacturing depreciation and amortization – Beginning inventory – Ending accounts payable	= Cash paid to suppliers
Operating expenses	+ Ending prepaid expense + Beginning accrued expenses	– Sales and administrative depreciation and amortization – Beginning prepaid expenses – Ending accrued expenses payable – Bad debt expenses	= Cash paid for operating expenses

The direct method permits the users to better comprehend the relationships between the company's net income (less) and its cash flows.

Indirect Method: [Reconciliation Method]

s method phasizes changes he component of t current assets current liability ounts.

Because of its simplicity, it is the most widely used presentation of cash flow from operating activities. It focuses on the differences between net income and cash flows. To find out the net cash flow from operating activities under this method, net income is adjusted for items of income statement not affecting cash flows. Moreover, this method emphasizes changes in the component of most current assets and current liability accounts. The following diagram may facilitate understanding of adjustments to net income necessary for converting accrued-based net income when using indirect method. [US. GAAP]

Current Assets +	Non-current Assets =	Current Liabilities +	Long-term Liabilities +	Income	Accrual income adjustment to convert to cash flow
Increase				Increase	Decrease
Decrease				Decrease	Increase
		Increase			Decrease
		Decrease			Increase

Shortcomings of this method:

(i) Users face difficulty in comprehending the information presented.

(ii) This method does not show where the cash came from and where cash went to.

Cash flows from operating activities calculated by the above two methods will be the same.

Modified Indirect Method

IAS # 7 suggests an alternative indirect method of calculating cash flow from operating activities. Under this method, the net cash flow from operating activities may be presented by showing the revenues and expenses disclosed in the income statement and the changes during the period in inventories and operating receivables and payables.

Performa for Calculating Cash Flows from Operating Activities:

(i) Direct Method

Cash Flow from Operating activities:		
Cash received from sale of goods	××××	
Cash interest received	××××	
Cash dividend received	××××	
Cash provided by operating activities		××××
Cash paid to suppliers	××××	
Cash paid for operating expenses	××××	
Cash interest paid	××××	
Cash paid for taxes	××××	
Cash disbursed for operating activities		(××××)
Net Cash Flow from operating activities		Tk.××××

(ii) Indirect Method

Net Income	Tk.××××
Adjustments needed to convert net income to a cash basis Depreciation, depletion, and amortization charge	+
Add: (Deduct) changes in current assets accounts affecting revenue and/or expenses	
Increase in the account	–
Decease in the account	+
Add: (Deduct) Changes in current liabilities affecting revenue or expense	
Increase in the account	+
Decrease in the account`	–
Add: (Deduct) loss or gain on sales of assets	
Gain on sale of assets	–
Loss on sale of assets	+
Add: (Deduct) Changes in the Deferred Income taxes A/C	
Increase in the account	+
Decrease in the account	–

Net cash provided by operating activities	Tk.××××

Example [Garrison] # 1

Rockford Company's comparative balance sheet for 2007 and the company's income statement for the year follow:

Rockford Company
Comparative Balance Sheet
December 31, 2007 and 2006
[dollars in millions]

	2007	2006
Assets	$	$
Cash	26	10
Accounts receivable	180	270
Inventory	205	160
Prepaid expenses	17	20
Plant & Equipment	430	309
Less: Accumulated Dep.	(218)	(194)
Long-term investments	60	75
Total Assets	$700	$650
Liabilities & Stockholders' Equity		
Accounts Payable	$230	$310
Accrued Liabilities	70	60
Bonds Payable	135	40
Deferred income taxes	15	8
Common Stock	140	140
Retained Earnings	$700	$650

Rockford Company
Income Statement
For the Year Ended December 31, 2007
[dollars in millions]

Net Sales	$1,000
Less: Cost of Sales	580
Gross Margin	470
Less: Operating expenses	352
Net Operating income	118
Non-operating items:	
Loss on sale of equipment	(4)

Income before taxes	114
Less: Income taxes	48
Net Income	$66

Note:

Dividends of $48 million were paid in 2007. The loss on sale of equipment of $4 million reflects a transaction in which equipment with an original cost of $12 million and accumulated depreciation of $5 million was sold for $3 million in cash.

Required:

Using the indirect method determine the net cash provided by operating activities and construct a statement of cash flow for the year 2007.

Solution:

Rockford Company
Statement of Cash Flow Worksheet
For the Year Ended December 31, 2007
[dollars in millions]

Assets (except cash or cash equivalent)	(1) Change	(2) Source or Use	(3) Cash Flow Effect	(4) Adjustment	(5) Adjusted Effect	(6) Classification
Current Assets:	$		$	$		
Accounts receivable	– 90	Source	+ 90		+ 90	Operating
Inventory	+ 45	Use	– 45		– 45	Operating
Prepaid expenses	– 3	Source	+ 3		+ 3	Operating
Non-Current Assets:						
Property, building & equipment	+ 121	Use	– 121	– 12	– 133	Investing
Long Term investment	– 15	Source	+ 15		+ 15	Investing
Contra Assets, Liabilities & Stockholders Equity Contra Assets:						
Accumulated Depreciation	+ 24	Source	+ 24	+ 5	29	Operating
Current Liabilities:						
Accounts payable	– 80	Use	– 80		– 80	Operating
Accrued liabilities	+ 10	Source	+ 10		+ 10	Operating
Non-current Liabilities						
Bonds payable	+ 95	Source	+ 95		+ 95	Financing
Deferred income taxes	+ 7	Source	+ 7		+ 7	Operating
Stockholder's Equity						
Common Stock	–					
Retained Earnings						
Net Income	+ 66	Source	+ 66		+ 66	Operating
Dividend	– 48	Use	– 48		– 48	Financing

Additional Entries:							
Proceeds from sale of assets					+ 3	+ 3	Investing
Loss on sale of equity					+ 4	+ 4	Operating

Rockford Company
Cash Flow Statement
For the Year Ended December 31, 2007
[Indirect Method]

($ million)

Net Income:	$	$
Adjustments to convert net income to a cash basis:	66	
Depreciation charges	29	
Decrease in receivables	90	
Increase in inventory	– 45	
Decrease in prepaid expenses	3	
Decrease in accounts payable	– 80	
Increase in accrued liabilities	10	
Increase in deferred income taxes	7	
Loss on sale of equipment	4	
Net Cash Flow provided by operating activities		84
Investment Activities:		
Additions to property, building and equipment	– 133	
Decrease in Long-term Investment	15	
Proceeds from sale of equipment	3	
Net Cash Flow from investing activities		– 115
Financing Activities:		
Increase in bonds payable	95	
Cash Dividend paid	– 48	
Net Cash Flow from financing activities		47
Net Increase in cash & cash equivalents:		16
Cash balance at the beginning		10
Cash balance at the end of 2007		26

Calculation of Net Cash Flow
from Operating Activities by
[Direct Method: [dollars in million]

Cash received from sales:		
Sales	1000	
Add: Beginning Accounts receivable	270	
Less: Ending Accounts receivable	(180)	$1090
Cash paid to suppliers:		
Cost of sales	+530	
Add: Beginning Accounts payable	+310	
Less: Ending Accounts payable	–230	
Add: Ending Inventory	+205	
Less: Beginning Inventory	–160	(655)
Cash paid for expenses:		
Operating Expenses	352	
Less: Depreciation	(29)	
Add: Income taxes paid	41	
Add: Beginning Accrued Liabilities	60	
Less: Ending Accrued Liabilities	(70)	
Less: Decrease in prepaid expenses	(3)	(351)
Net Cash Flow from operating activities:		84

Example [Khan & Jain] # 2

The following are the summarised balance sheets of Sound Ltd. as on March 31 for two consecutive year 1 and year 2:

[Tk. '000]

Particulars	Year 2	Year 1
Assets:	Tk.	Tk.
Plant and machinery	1,980	1,010
Land and buildings	1,000	1,000
Long term investments	550	550
Short term investments	470	85
Sundry debtors	2,195	2,500
Investaries	1,400	1,300
Interest receivables	100	65
Cash in hand	300	500
Cash at bank	405	300
Total	**8,400**	**7,310**
Liabilities		
Share Capital	2,600	2,150
Reserve and surplus	1,460	900
15% Debentures	2,000	1,800
Sundry Creditors	440	650
Wages outstanding	40	20
Income Tax payable	400	450
Accumulated Depreciation:		
Plant and machinery	910	840
Land and buildings	550	500
Total	**8,400**	**7,310**

Income Statement for the period ending March 31, year 2

	(Tk.'00)
Sales revenue	45,300
Less: Cost of Goods sold	39,000
Gross Profit	6,300
Less: Depreciation	(540)
Selling and administrative expenses	(2,960)
Interest paid	(300)
Add: Interest income	65
Dividend income (gross)	95
Net Income before extra-ordinary item	2660
Add: insurance settlement received	10
	2,670

Less: Provision for income taxes	550
	2,120

Additional Information: (Tk.'000)

(i) 15% Debenture of Tk.300 was redecmed during year 2.

(ii) Tax deducted at source on dividends received (included in provision for taxes) amounts to Tk.15.

(iii) A plant costing Tk.500, having accumulated depreciation of Tk.420 was sold for Tk.80.

(iv) During year 2, interim dividend of Tk.760 was paid, final dividend paid was Tk.800.

(v) All sales and purchases are made on credit basis.

You are required to prepare a cash flow statement.

Solution:

Sound Ltd.
Statement of Cash Flow Worksheet
For the Period Ended December 31, year 2

Assets (except cash or cash equivalent)	(1) Change	(2) Source or Use	(3) Cash Flow Effect	(4) Adjustmen t	(5) Adjusted Effect	(6) Classificatio n
Current Assets:						
Short-term investments	+385	Use	–385		–385	
Sundry Debtors	–305	Source	+305		+305	Operating
Inventories	+100	Use	–100		–100	Operating
Interest receivable	+35	Use				
Fixed Assets:						
Plant & Machinery Land & Building	+1470	Use	–1470		–1470	Investing
Long-term investment	–	–	–	–	–	–
Liabilities:						
Share Capital	+450	Source	+450		+450	Financing
Reserve & Surplus 15% Debenture	+200	Source	+200		+200	Financing
Current Liabilities:						
Sundry Creditors	–210	Use	–210		–210	Operating
Wages outstanding	+20	Source	+20		+20	Operating
Income tax payable	–50	Use	–50		–50	Operating
Contra Account:						
Accumulated Dept. Plant & Machinery	+490	Source	+490		+490	Operating
Land & Building	+50	Source	+50		+50	Operating
					–700	

Sound Limited
Statement of Cash Flow
For the Period Ended December 31, year 2
[Indirect Method]

(Tk.'000)

	Tk.	Tk.
Cash Flow from operating activities:		
Net Income before extra-ordinary item	2,660	
Add: Depreciation	540	
Interest paid	300	
Less: Interest income	(65)	
Dividend income	(95)	
Operating profit before working capital change	3,340	
Decrease in Sundry debtor	305	
Increase in outstanding wage	20	
Increase in inventory	–100	
Decrease in sundry creditors	–210	
Increase in short-term investment	–385	
Income taxe paid	–585	
Cash flow before extra-ordinary item	2,385	
Add: Insurance settlement	10	
Net Cash flow from operating activities		2,395
Cash flow from investing activities		
Purchase of plant and machinery	–1,470	
Interest received	30	
Dividend received	80	
Sale of plant	80	
Net Cash flow from investing		(1,280)
Cash flow financing activities:		
Issuance of share capital	+450	
Issuance of 15% Debenture	+500	
Redemption of Debenture	–300	
Interest paid	–300	
Dividend paid	–1,560	
Net Cash flow from financing activities		(1,210)
Net decrease in cash		(95)
Beginning cash balance		800
Ending cash balance		705

Example # 3

From the following data of P. & Sons Ltd., prepare a Cash Flow Statement for the year 2007:

P & Sons Ltd.
Balance Sheet
As on 31st December

[Tk.'000]

Liabilities	2007	2006	Assets	2007	2006
Accumulated Depreciation	275	150	Cash	315	285
Creditors	100	75	Marketable Securities	106	50
Bills Payable	50	25	debtors	150	125
Debentures	500	250	Inventories	95	70
Equity Capital	550	400	Investments	70	110
Premium on Shares	60	–	Machinery	500	350
Retained Earnings	336	325	Building	600	200
			Land	35	35
Total	1871	1225	Total	1871	1225

P & Sons Ltd.
Income Statement
For the Year Ended December 31, 2007

[Tk.'000]

Sales	600
Less: Cost of Goods sold	337
Gross margin on sales	263
Less: Operating expenses:	
Depreciation:	
Machinery	50
Building	80
Other expenses	100
	230
Net margin from operation	33
Gain on sales of long term investments	12
Total	45
Loss on sales of machinery [proceeds from sales Tk.15,000]	5
Net Income	40

Solution:

P & Sons Ltd.
Statement of Cash Flow
For the Year Ended December 31, 2007

[Tk.'000]

Cash flow from operating activities:	Tk.	Tk.
Net Income	40	
Less: Gain on sales of Long-term Investments	–12	
Add: Loss on sale of machinery	+5	
Add: Depreciation : Machinery	+50	
Building	+80	
Less: Increase in Debtors	–25	
Less: Increase in Inventories	–25	
Add: Increase in Creditors	+25	
Payables	+25	
Net Cash Flow from operating activates		163
Cash Flow from investing activities:		
Sales of machinery	+15	
Sales of Long term investment	+52	
Purchase of Building	–400	
Purchase of Machinery	–175	
Net Cash Flow from investing activities		(508)
Cash Flow from financing activities:		
Sales of Debentures	250	
Equity	210	
Dividend paid	–29	
Net Cash Flow financing activities		431
Net Increase in Cash & Cash equivalents		86
Cash & Cash Equivalent at the beginning		335
Cash & Cash Equivalent at the end		421

Example # 4

The financial statements of Louis Zimmer Company appear below:

Louis Zimmer Company
Comparative Balance Sheets
December 31, 2007

Assets	**2007**	**2006**
Cash	Tk.31,000	Tk.13,000
Accounts Receivable	28,000	14,000
Merchandise Inventory	25,000	35,000
Preperty, Plant, Equipment	60,000	78,000
Accumulated Depreciation	(22,000)	(24,000)
Total	**Tk.122,000**	**Tk.116,000**
Liabilities and Stockholder's Equity		
Accounts Payable	Tk.27,000	Tk.23,000
Income taxes Payable	5,000	8,000
Bonds Payable	27,000	35,000
Common Stock	18,000	14,000
Retained Earnings	45,000	36,000
Total	**Tk.122,000**	**Tk.116,000**

Louis Zimmer Company
Income Statement
For the Year Ended December 31, 2007

Sales		Tk.220,000
Less: Cost of Goods sold		180,000
Gross Profit		40,000
Less: Operating Expenses:		
Selling Expense	Tk.14,000	
Administrative Expense	8,000	22,000
Income from operations:		18,000
Interest Expense		1,000
Income before income taxes		17,000
Income taxes		4,000
Net Income		Tk.13,000

Additional Information:

(i) Dividend declared and paid were Tk.4,000.

(ii) During the year equipment was sold for Tk.8,500 cash. This equipment cost Tk.18,000 originally and had a book value of Tk.8,500 at the time of sale.

(iii) All depreciation expenses are in the selling expense category.

(v) All sales and purchases are on credit.

Prepare a Cash Flow Statement using indirect method.

Solution:

Louis Zimmer Company
Statement of Cash Flow
For the Year Ended December 31, 2007

Cash Flow from operating activates:	Tk.	Tk.
Net Income	13,000	
Add Depreciaton	+ 7,500	
Interest Expense	+ 1,000	
Decrease in Inventory	+ 10,000	
Increase in Accounts payable	+ 4,000	
Less Increase in Accounts receivable	– 14,000	
Balance of Income tax paid	– 3,000	
Net Cash Inflow from operating activities		18,500
Cash Flow from Investing Activities:		
Sale of equipment		8,500
Cash Flow from financing activities:		
Repayment of Bonds	– 8,000	
Sale of Common Stock	+ 4,000	
Interest paid	– 1,000	
Dividend paid	– 4,000	
Net Cash Flow from financing activities		(9,000)
Net Increase in cash		18,000
Add Beginning Cash balance		13,000
Ending Cash Balance		31,000

If interest paid is treated as cash outflow on account of operating activities, then net cash flow from operating activities will be Tk.17,500 (Tk.18,500–1,000).

Example # 5

The financial statements of Earnest Company appear below:

Earnest Company
Comparative Balance Sheets
December 31, 2007

Assets	**2007**	**2006**
Cash	Tk.23,000	Tk.13,000
Accounts Receivable	24,000	33,000

Merchandise Inventory	20,000	27,000
Prepaid Expenses	20,000	13,000
Land	40,000	40,000
Preperty, Plant & Equipment	2,00,000	2,25,000
Less: Accumulated Depreciation	(50,000)	(67,500)
Total	**Tk.2,77,000**	**Tk.2,83,500**
Liabilities and Stockholder's Equity		
Accounts Payable	Tk.9,000	Tk.18,500
Accured Expenses payable	9,500	7,500
Interest payable	1,000	1,500
Income taxes Payable	3,000	2,000
Bonds Payable	50,000	80,000
Common Stock	1,23,000	105,000
Retained Earnings	81,000	69,000
Total	**Tk.2,77,000**	**Tk.2,83,000**

Earnest Company
Income Statement
For the Year Ended December 31, 2007

	Taka	**Taka**
Revenues:		
Sales	600,000	
Gain on sale of plant assets	2,500	
		6,02,500
Less Expenses:		
Cost of Goods sold	500,000	
Operating expenses except depreciation	60,000	
Depreication expenses	7,500	
Interest Expenses	5,000	
Income t ax expenses	9,000	
		5,81,500
Net Income		21,000

Additional Information:

(i) Plant assets were sold at a sales price of Tk.62,500.

(ii) Additional equipment was purchased at a cost of Tk.60,000.

(iii) Dividends of Tk.8,500 were paid.

(iv) All sales and purchases were on account.

(v) Bonds were redeemed at face value.

(vi) Additional shares of stock were sold for cash.

Prepare a Statement of cash flow of the Earnest Company for the year 2007 using indirect method.

Solution:

The Earnest Company
Statement of Cash Flow
For the Year Ended December 31, 2007

	Tk.	Tk.
Cash Flow from operating activates:		
Net Income	21,000	
Add Depreciaton Expense	7,500	
Income Taxes	9,000	
Decrease in Accounts Receivable	9,000	
Accrued Expenses	2,000	
Increase in Inventory	7,000	
Less Increase in Prepaid Expense	(7,000)	
Decrease in Accounts Payable	(9,000)	
Decrease in Interest Payable	(500)	
Income tax paid	(8,000)	
Gain on sale of plant	(2,500)	
Net Cash Inflow from operating activities		28,000
Cash Flow from investing activities:		
Sale of Plant assets	62,500	
Purchase of equipment	(60,000)	
Net Cash Flow from investing activities		2,500
Net Cash Flow from financing activity:		
Sale of Common shares	18,000	
Bonds redeemed	(30,000)	
Dividend paid	(8,500)	
Net Cash Flow from financing activity		(20,500)
Increase of Cash		10,000
Add Beginning Balance of Cash		13,000
Ending Balance of Cash		23,000

Some Special Issues Relating to Cash Flow Statement

Foreign Currency Cash Flows:

(a) Cash flows arising from transactions in a foreign currency should be recorded in an enterprise's reporting currency by applying the exchange rate at the date of the cash flow.

(b) Cash flows of a foreign subsidiary should be translated at the exchange rates at the dates of the cash flows.

Extra-ordinary items: Cash flows associated with extra-ordinary items should be classified as arising from operating, investing or financing activities as appropriate and separately disclosed.

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

Acquisitions and Disposals of Subsidiaries and other business units: The aggregate cash flows arising from acquisitions and from disposals of subsidiaries or other business units should be presented separately as classified as investing activities.

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

Cash Flow per share: There is presently no requirement to disclose such information in the financial statements of an enterprise.

Free Cash Flow: In the statement of cash flows, cash provided by operating activities is intended to indicate the cash generation capability of the company. Analysts have noted that cash provided by operating activities fails to take into account that a company must invest in new fixed assets just to maintain its current level of operations. Companies must also at least maintain dividends at current level to satisfy investors. A measurement to provide additional insight regarding a company's cash generating ability is free cash flow.

Free Cash Flow = Cash Flow from Operation – Capital expenditure + Disposition of Property and equipment – Cash Dividends.

Self-Assessment Questions:

Indicate either true or false statements by using ‘T’ or ‘F’ respectively.

(i) Funds are sum of money or stock convertible to money.

(ii) There are three types of statements relating to funds flow.

(iii) Outsiders are benefited from the Funds Flow Statement but not the internal managers.

(iv) An increase in current assets cannot always increase working capital.

(v) Income from dividend should be added to find out the funds from operation.

(vi) Writing off of preliminary expenses is an element of operating expense.

(vii) Inclusive of Cash Flow Statement in the annual report is voluntary in Bangladesh.

(viii) The Companies Act 1994 requires companies to publish their Value-added Statement.

(ix) Funds Flow Statement can help measure the ability to meet obligations and pay dividends.

(x) Cash Flow Statement can also be prepared on the basis of forecasts.

(xi) Funds Flow Statements are prepared on the basis of balance sheet data.

(xii) Cash Flow Statement eliminates the effects of alternative accounting treatments of the same transactions and events.

(xiii) Cash Flows are inflows and outflows of cash and cash equivalents.

(xiv) In the U.K. cash flows are classified into more than three categories.

(xv) Direct and indirect methods of determining net cash flow from operating activities will produce different results.

(xvi) Direct method is also known as “Reconciliation” method.

(xv) In financial institutions “Interest Received” and “Paid” must be treated as an operating cash flow.

(xvi) Normally, income tax payments are treated as cash flows from operating activities.

(xvii) Cash flows from extra-ordinary items must be shown as a separate item.

(xviii) Cash flow per should also be shown in the Cash Flows Statement.

(xix) Free Cash Flow will always, be high than Net Cash Flow’ from operating activities.

(xx) Sale of plant and equipment is an item of cash flow from investing activities.

Answer:

(i) (ii) (iii) (iv) (v) (vi) (vii) (viii) (ix) (x) (xi) (xii) (xiii) (xiv) (xv) (xvi) (xvii) (xviii) (xix) (xx)

Questions

1. What are funds? Describe the statements relating to funds
2. What is a 'Funds Flow Statement'? What is the importance of this statement to managers of the enterprise, investors and creditors?
3. Explain the procedure for determination of funds from operation.
4. What is a statement of changes in financial position? How does it differ from funds flow or cash flow statement?
5. What are the uses of a statement of sources and uses of working capital? When is it more appropriate to prepare a statement of cash flow?
6. What is the purpose of a statement of cash flow?
7. What are cash equivalents, and why are the included with cash on a statement of cash flow?
8. What are the three major sections on a statement of cash flows, and what are the general rules that determine the transactions that should be included in each section?
9. How do the direct and indirect methods differ in their approach to computing the cash provided by operating activities?
10. A business executive once stated, 'Depreciation is one of our biggest sources of cash.' Do you agree that deprecation is a source of cash? Explain.
11. What are the limitations of a 'Funds Flow Statement? In what ways, a Cash Flow Statement can help the uses?
12. Differentiate between a 'Cash Flow Statement' and a 'Funds Flow Statement'.
13. What are the objectives of preparing a 'Cash Flow Statement'? Discuss the uses of Statement of Change in Financial position.

Problems [Funds Flow Statement]

1. The comparative balance sheets of Alpha Company showed the following changes in balance sheet items from 2006 to 2007:

	Taka
Working capital	127,500 increase
Long-term investments	45,000 increase
Land	48,000 increase
Machinery (less accumulated depreciation)	90,000 increase
15% Debentures	240,000 increase
Share capital	60,000 increase
Reserves and surplus	10,500 decrease

The following additional data are provided: (i) Net profit for the year was Tk.157,500 (ii) Accumulated depreciation for 2006 was Tk.67,500 and for 2007 Tk.90,000. (iii) A machine of Tk.112,500 was purchased during the year; depreciation expenses for the year was Tk.22,500. (iv) A bonus issue of shares of Tk.60,000 was made during the year. (v) A cash dividend of Tk.87,000 was declared and paid during the year.

Instruction:

Prepare a statement of changes in financial position for Alpha Company.

2. The comparative balance sheets for Padma Pvt. Ltd. are given below:

Padma Pvt. Ltd.
Comparative Balance Sheet
For the Year Ended on 31 December

		(Taka)
	2007	**2006**
Assets		
Cash	82,000	22,000
Debtors	104,000	24,000
Stock	112,000	60,000
Prepaid expenses	22,000	14,000
Plant and machinery	380,000	360,000
Goodwill	36,000	40,000
Total	**736,000**	**520,000**
Liabilities & Equities		
Creditors	30,000	14,000
Provision for depreciation	100,000	60,000
Debentures	102,000	102,000
Premium on debentures issue	12,000	18,000
Share capital	190,000	90,000

Share premium	30,000	–
Reserves and surplus	272,000	236,000
Total	**736,000**	**520,000**

The company made a net profit of Tk.66,000 during the year. Prepare a statement of changes in financial position on (a) working capital basis, (b) cash basis. Also prepare a schedule of working capital changes.

3. From the following data of Kohinoor Company, prepare a statement of changes in financial position.

Kohinoor Company
Balance Sheet
For the Year Ended on 31 March

		(Taka)
	2007	**2006**
Assets		
Cash	30,000	22,500
Debtors	45,000	40,000
Stock	20,000	16,000
Long-term investments	15,000	25,000
Machinery	20,000	12,500
Buildings	45,000	37,500
Land	10,000	10,000
Total	**185,000**	**163,500**
Liabilities and Equity		
Provision for depreciation:		
Machinery	3,750	1,500
Buildings	9,000	6,000
Provision for doubtful debts	1,500	1,000
Creditors	20,000	16,500
Outstanding expenses	2,250	1,750
Loan (adjust security of machinery)	22,500	25,000
Share capital	100,000	100,000
Reserves and surplus	26,000	11,750
Total	**185,000**	**163,500**

Additional data:

(i) Net profit for the year 2007 is Tk.27,500.

(ii) Machinery costing Tk.2,500, on which depreciation of Tk.500 has accumulated, was sold for Tk.3,000. The gain is included in net profit.

(iii) Investments costing Tk.10,000 were sold during the year for Tk.12,500. The gain is included in net profit.

(iv) Cash dividends paid during the year, Tk.13,250.

4. Prepare (a) a statement of changes in financial position on (i) working capital basis, (ii) cash basis, and (b) a schedule of changes in working capital from the following data:

M Company
Balance Sheet
For the Year Ended on 30 June

[Taka]

Assets	2006	2007	Liabilities & Equities	2006	2007
Cash	15,000	9,000	Creditors	60,000	0
Marketable Securities	21,000	15,000	Bills payable	15,000	24,000
Debtors	30,000	45,000	Accrued expenses	6,000	6,000
Stock	36,000	45,000	Tax payable	9,000	15,000
Fixed assets, net	150,000	1,65,000	Long-term debt	0	45,000
Other non-current assets	24,000	15,000	Share capital including reserve	180,000	210,000
	270,000	3,00,000		270,000	300,000

M Company
Profit and Loss Account
For the Year Ended on 30 June

		(Taka)
Sale		150,000
Expenses:		
Cost of goods sold	75,000	
Selling, general and administrative expenses	15,000	
Depreciation	15,000	
Interest	3,000	108,000
Profit before tax		42,000
Less: Tax		21,000
Profit after tax		21,000
Reserve, 30 June 2006		120,000
		141,000
Less: Cash dividends		9,000
Reserve, 30 June 2007		132,000

5. Balance sheet and profit and loss account of Ahmed Sons Company Limited as on December 31, 2006 and 2007 are as follows:

JB Sons
Bangladesh Sheet
As 31 December

[Taka]

Liabilities	2006	2007	Assets	2006	2007
Accounts payable	15,000	25,000	Cash balance	5,000	2,000
Cash credit	13,000	10,000	Accounts receivable	10,000	8,000
Outstanding expenses	2,000	3,000	Loan and advances	5,000	–
Long-term loan	30,000	30,000	Inventories	20,000	25,000
Capital	30,000	30,000	Fixed assets (net)	60,000	65,000
Surplus	10,000	12,000			
	100,000	100,000		100,000	100,000

Ahmed Sons Company
Profit and Loss Account
For the Year Ended on 30 June

	(Taka)
Sale	200,000
Less: Cost of goods sold (including depreciation of Tk.10,000)	170,000
Gross profit	30,000
Less: Other expenses	20,000
Income before tax	10,000
Less: Income-tax provision	5,000
Income after tax	5,000

Instruction:

Prepare a statement of sources and uses of funds.

6. A company finds on 1 January, 2007, that it is short of funds with which to implement its programme of expansion. On 1 January, 2005, it had a cash credit balance of Tk.180,000. From the following information, prepare a statement for the board of directors to show how the overdraft of Tk.68,750 as at the 31 December, 2006 has arisen:

	2005 Tk.	2006 Tk.		2005 Tk.	2006 Tk.
Fixed assets	750,000	11,20,000	Trade creditors	270,000	350,000
Stock and stores	190,000	330,000	Share capital	250,000	300,000
Debtors	380,000	335,000	(in share of		
Bank balance	180,000		–Tk.10 each)		
Bank overdraft	–	68,750	Bills receivables	87,500	95,000

The profit for the year ended December 31, 2006 before charging depreciation and taxation amounted to Tk.240,000. The 5,000 shares were issued on 1 January 2006 at a premium of Tk.5 per share, and Tk.137,500 was paid in March 2006 by way of income tax. Dividend was paid as follows: on the capital on 31 December, 2005 at 10% less tax at 25%, 2006 (interim) 5 per cent free of tax.

7. From the following data of Matin Sons Limited, prepare a statement of sources and uses of funds:

Matin Sons Limited
Bangladesh Sheet
As on 31 December

[Taka'000]

Liabilities	2007	2006	Assets	2007	2006
Accumulated depreciation	275	150	Cash	315	285
Creditors	100	75	Marketable securities	106	50
Bills payable	50	25	Debtors	150	125
Debentures	500	250	Inventories	95	70
Equity capital	550	40	Investments	70	110
Premium on shares	60	–	Machinery	500	350
Retained earning	336	325	Buildings	600	200
			Land	35	35
	1,871	1,225		1,871	1,225

Matin Sons Limited
Income Statement
For the Year Ended December 31, 2007

[Taka'000]

Sale		600
Cost of goods sold		337
Gross margin on sales		263
Operating expenses:		
Depreciation – machinery	50	
– building	80	
Other expenses	100	230
Net margin from operations		33
Gain on sales of long-term investments		12
Total		45
Loss on sales of machinery (proceeds from sales Tk.15,000)		5
Net income		40

8. From the following balance sheet of Alpha Ltd. make out (1) statement of changes in the working capital, and (2) funds flow statement:

Alpha Co.
Balance Sheet

[Taka]

Liabilities	2007	2006	Assets	2007	2006
Equity share capital	300,000	400,000	Goodwill	100,000	80,000
8% Redeemable Preference capital	150,000	100,000	Land and building	200,000	170,000
Capital reserve	–	20,000	Plant	80,000	200,000
General reserve	40,000	50,000	Investments	20,000	30,000
Profit and loss account	30,000	48,000	Sundry debtors	140,000	170,000
Proposed dividend	42,000	50,000	Stock	77,000	109,000
Sundry creditors	25,000	47,000	Bills receivable	20,000	30,000
Bills payable	20,000	16,000	Cash in hand	15,000	10,000
Liabilities for expenses	30,000	36,000	Cash at bank	10,000	8,000
Provision for taxation	40,000	50,000	Preliminary expenses	15,000	10,000
	677,000	817,000		677,000	817,000

Additional data: (i) A piece of land has been sold out in 2007 and the profit on sale has been carried to capital reserve. (ii) A machine has been sold for Tk.10,000. The written down value of the machine was Tk.12,000. Depreciation of Tk.10,000 is charged on plant account in 2007. (iii) The investments are trade investments; Tk.3,000 by way of dividend is received including Tk.1,000 from pre-acquisition profit which has been credited to investment account. (iv) An interim dividend of Tk.20,000 has been paid in 2007.

9. The following are the summaries of the balance sheets of Victory Limited as on 31 December, 2006 and 31 December 2007.

Victory Ltd.
Balance Sheet

[Taka]

Liabilities	2006	2007	Assets	2006	2007
Sundry creditors	39,500	41,135	Cash at bank	2,500	2,700
Bills payable	33,780	11,525	Sundry debtors	87,490	73,360
Bank overdraft	59,510	–	Stock	111,040	97,370
Provision for taxation	40,000	50,000	Land and building	148,500	144,250
Reserves	50,000	50,000	Plant and machinery	112,950	116,200
Profit and loss account	39,690	41,220	Goodwill	–	20,000
Share capital	200,000	260,000			
	462,480	453,880		462,480	453,880

The following additional information is obtained from the general ledger: (a) During the year ended December 2007 an interim dividend of Tk.26,000 was paid. (b) The assets of another company were purchased for Tk.60,000 payable in fully paid shares of the company. These assets consisted of stock Tk.22,000, machinery Tk.18,000, and goodwill Tk.20,000. In addition sundry purchases of plant were made totalling Tk.5,600. (c) Income-tax paid during the year amounted to Tk.25,000. (d) The net profit for the year before tax was Tk.65,530.

Instruction:

Prepare a statement showing the sources and application of funds for the year 2007 and a schedule setting out changes in working capital.

10. The comparative balance sheets of Sonali Industries Ltd. as on 31 December, 2006 and 2007 are as under:

Sonali Industries Ltd.
Balance Sheet

[Taka in lakh]

Liabilities	2006	2007	Assets	2006	2007
Current Liabilities			**Current Assets**		
Sundry creditors	40.40	43.20	Cash at bank	44.60	47.80
Provision for taxation	10.80	12.20	Debtors	10.80	17.00
Liabilities for expenses	2.60	1.00	Stock-in-trade	44.00	67.20
Total current liabilities	53.80	46.40	Miscellaneous	30.20	8.00
Long-term Loans	22.00	21.00	Total current assets	129.60	140.00
Total liabilities	75.80	77.40	**Fixed Assets**		
Owner's Equity			Plant, mach. & bldng.	283.40	368.00
Paid—up capital	280.00	320.00	*Less:* Total depreciation	25.80	34.20
				257.60	333.80
Reserves and surplus	140.60	163.60	Land	50.00	50.00
Total equity	420.60	483.60	Total fixed assets	307.60	383.80
			Investments	42.40	25.20
			Intangible Assets	16.80	12.00
			Total non-current assets	366.80	421.00
Total Liabilities & Capital	**496.40**	**561.00**	**Total Assets**	**496.40**	**561.00**

The income for the year amounted to Tk.57.80 lakh after charging depreciation of Tk.8.40 lakh but before making the following adjustments: (i) profit on land purchased and sold in 2007, Tk.15.60 lakh; (ii) loss on sale of marketable securities Tk.2.80 lakh, included under miscellaneous current assets; (iii) write off intangible assets Tk.4.80 lakh; (iv) write off long-term investments Tk.17.20 lakh.

The dividend declarged and paid during the year amounted to Tk.25.60 lakh.

Instruction

From the above particulars prepare: (i) statement of sources and application of funds, and (ii) statement of changes in working capital.

11. Following are the summarised balances of Maruf Limited on 30 June, 2006 and 2007.

Maruf Limited
Balances as on 30 June

Taka

	2006		*2007*	
	Dr.	***Cr.***	***Dr.***	***Cr.***
Equity Share Capital				
30,000 shares of Tk.10 each issued and fully paid	–	300,000	–	300,000
Capital reserve	–	–	–	49,200
14% Debentures	–	–	–	50,000
Debenture discount	–	–	1,000	–
Freehold property at cost	122,000	–	–	–
Freehold property at valuation	–	–	165,000	–
Plant and machinery at cost	223,000	–	283,000	–
Depreciation on plant and machinery	–	107,600	–	122,000
Debtors	104,600	–	154,600	–
Stock and work-in-progress	124,000	–	162,500	–
Creditors	–	37,400	–	49,200
Profit and loss account	–	112,000	–	112,000
Net profit for the year	–	–	–	76,500
Dividend in respect of 19x1	–	–	30,000	–
Provision for doubtful debts	–	3,100	–	6,400
Trade investment at cost	–	–	47,000	–
Bank	–	13,500	–	77,800
	573,600	573,600	843,100	843,100

You are informed that; (i) The capital reserve on 30 June, 2007 represented the realised profit on the sale of one freehold property together with the surplus arising on revaluation. (ii) During the year ended 30 June, 2007, plant costing Tk.18,000 against which a depreciation provision of Tk.13,500 had been made, was sold for Tk.7,000. (iii) On 1 July, 2006, Tk.50,000 debentures were issued for cash at a discount of Tk.1,000. (iv) The net profit for the year is arrived at after crediting the profit on the sale of machinery and charging debenture interest.

Instruction:

You are required to prepare a statement which will explain why bank borrowing has increased by Tk.64,300 during the year ended 30 June 2007. Taxation is to be ignored.

12. From the information provided, you are required to prepare a "Source and Disposition of Funds" statement explaining how Cresent Limited has improved cash position in the year ended 31 December 2007. The summarised balance sheets of Cresent Limited as on 31 December 2006 and 31 December 2007 were as follows:

Cresent Ltd.
Balance Sheet

[Taka]

Liabilities	2006	2007	Assets	2006	2007
Issued share capital	100,000	150,000	Freehold property	110,000	130,000
Share premium	15,000	35,000	Plant and machinery	120,000	151,000
Profit and loss	28,000	70,000	Fixtures and fittings, at cost	24,000	29,000
Debentures	70,000	30,000	Stocks	37,000	51,000
Bank overdraft	14,000	–	Debtors	43,000	44,000
Creditors	34,000	48,000	Bank balance	–	16,000
Proposed dividends	15,000	20,000	Premium on redeemed debentures	–	1,000
Depreciation:					
Plant	45,000	54,000			
Fixtures	13,000	15,000			
	334,000	422,000		334,000	422,000

The following additional information is relevant: (i) There had been no disposal of freehold property in the year. (ii) A machine tool which has cost Tk.8,000 and in respect of which Tk.6,000 depreciation has been provided was sold for Tk.3,000 and fixtures, which had cost Tk.5,000 in respect of which depreciation of Tk.2,000 had been provided, were sold for Tk.1,000. The profits and losses on these transactions had been dealt with through the profit and loss account. (iii) The actual premium on the redemption of debentures was Tk.2,000 of which Tk.1,000 has been written off to the profit and loss account. (iv) No interim dividend has been paid.

Problems [Cash Flow Statement]

1. The income statement of WARID Company is shown below:

WARID Company
Income Statement
For the Year Ended December 31, 2007

Sales		7,200,000
Cost of goods sold		
Beginning inventory	1,700,000	
Purchases	5,430,000	
Goods available for sale	7,130,000	
Ending inventory	1,920,000	
Cost of goods sold		5,210,000
Gross profit		1,990,000
Operating expenses		
Selling expenses	380,000	
Administrative expenses	525,000	
Depreciation expenses	95,000	
Amortization expense	30,000	1,030,000
Net income		960,000

Additional information:

1. Account receivable increased Tk.690,000 during the year.
2. Prepaid expenses increased Tk.170,000 during the year.
3. Accounts payable to merchandise suppliers increased Tk.35,000 during the year.
4. Accrued expenses payable decreased Tk.190,000 during the year.

Instructions

Prepare the operating activities section of the statement of cash flows for the year ended December 31, 2007, for Wayne Rogers Company using the indirect methods.

2. Data for WARID Company are presented in P-1

Instructions

Prepare the operating activities section of the statement of cash flows using the direct method.

3. The income statement of Nandan Park Co. for the year ended December 31, 2007, reported the following condensed information.

Revenue from fees	Tk.510,000
Operating expenses	280,000
Income from operations	230,000
Income tax expense	57,000
Net income	Tk.173,000

Nandan Park's balance sheet contained the following comparative data at December 31.

	2007	**2006**
Accounts receivable	Tk.55,000	Tk.60,000
Accounts payable	32,000	41,000
Income t axes payable	2,000	4,000

Nandan Park has no depreciable assets. (Accounts payable pertains to operating expenses.)

Instructions:

Prepare the operating activities section of the statement of cash flows using the direct method.

4. Presented below are the comparative balance sheets for Canca Works Company as of December, 31.

Canca Company
Comparative Balance Sheets
December 31

Assets	**2007**	**2006**
Cash	Tk.38,000	Tk.45,000
Accounts receivable	49,500	52,000
Inventory	153,450	142,000
Prepaid expenses	15,780	21,000
Land	100,000	130,000
Equipment	228,000	155,000
Accumulated depreciation-equipment	(45,000)	(35,000)
Building	200,000	200,000
Accumulated depreciation-building	(60,000)	(40,000)
	Tk.679,730	Tk.670,000

Liabilities and Stockholders' Equity		
Accounts payable	Tk.35,730	Tk.40,000
Bonds payable	250,000	300,000
Common stock, Tk.1 par	200,000	150,000
Retained earnings	194,000	80,000
	Tk.679,730	Tk.670,000

Additional information:

1. Operating expenses include depreciation expense of Tk.42,000.
2. Land was sold for cash at book value.
3. Cash dividends of Tk.24,000 were paid.
4. Net income for 2007 was Tk.38,000.
5. Equipment was purchased for Tk.95,000 cash. In addition, equipment costing Tk.22,000 with a book value of Tk.10,000 was sold for Tk.8,100 cash.
6. Bonds were converted at face value by issuing 50,000 shares of Tk.1 par value common stock.
7. Net sales for 2007 totaled Tk.420,000.

Instructions

(a) Prepare a statement of cash flows for the year ended December 31, 2007, using the indirect method.

(b) Compute free cash flow for 2007.

5. The financial statements of James Lyman Company appear below:

James Lyman Company
Comparative Balance Sheets
December 31

Assets		**2005**		**2004**
Cash		Tk.24,000		Tk.16,000
Accounts receivable		20,000		11,000
Merchandise inventory		38,000		35,000
Property, plant, and equipment	Tk.70,000		Tk.78,000	
Less: Accumulated depreciation	(30,000)	40,000	(24,000)	54,000
Total		Tk.122,000		Tk.116,000
Liabilities and Stockholders' Equity				
Accounts payable		Tk.23,000		Tk.33,000
Income taxes payable		15,000		20,000
Bonds payable		20,000		10,000
Common stock		25,000		25,000
Retained earnings		39,000		28,000
Total		Tk.122,000		Tk.116,000

Aromatic Lyman Company
Income Statement
For the Year Ended December 31, 2007

Sales		Tk.240,000
Cost of goods sold		180,000
Gross profit		60,000
Operating expenses:		
Selling expenses	Tk.23,000	
Administrative expenses	10,000	33,000
Income from operations		27,000
Interest expense		2,000
Income before income taxes		25,000
Income tax expense		7,000
Net income		Tk.18,000

Additional information:

1. Dividends of Tk.7,000 were declared and paid.
2. During the year equipment was sold for Tk.11,000 cash. This equipment cost Tk.15,000 originally and had a book value of Tk.11,000, at the time of sale.
3. All depreciation expense, Tk.10,000, is in the selling expense category.
4. All sales and purchases are on account.
5. Additional equipment was purchased for Tk.5,000 cash.

Instructions

(a) Prepare a statement of cash flows using the indirect method.

(b) Compute free cash flow.

6. Condensed financial data of TC Beverage Ltd. appear below:

TC Beverage Ltd.
Comparative Balance Sheets
December 31

Assets	**2007**	**2006**
Cash	Tk.98,700	Tk.47,250
Accounts receivable	87,800	56,000
Inventories	121,900	103,650
Investments	81,500	87,000
Plant assets	250,000	205,000
Accumulated depreciation	(49,500)	(40,000)
	Tk.590,400	Tk.458,900
Liabilities and Stockholders' Equity		
Accounts payable	Tk.57,700	Tk.48,280
Accrued expenses payable	12,100	18,830

Bonds payable	100,000	80,000
Common stock	250,000	200,000
Retained earnings	170,600	111,790
	Tk.590,400	Tk.458,900

Additional information:

1. New plant assets costing Tk.92,000 were purchased for cash during the year.
2. Investments were sold at cost.
3. Plant assets costing Tk.47,000 were sold for Tk.15,550, resulting in a gain of Tk.8,750.
4. A cash dividend of Tk.88,400 was declared and paid during the year.

Instructions

Prepare a statement of cash flows using the indirect method.

7. Presented below are the comparative balance sheets for Partex Company at December, 31:

Partex Company
Comparative Balance Sheets
December 31

Assets	**2007**	**2006**
Cash	Tk.45,000	Tk.57,000
Accounts receivable	72,000	64,000
Inventory	132,000	147,000
Prepaid expenses	12,140	16,540
Land	125,000	150,000
Accumulated depreciation-equipment	(60,000)	(50,000)
Building	250,000	250,000
Accumulated depreciation-building	(75,000)	(50,000)
	Tk.701,140	Tk.760,540
Liabilities and Stockholders' Equity		
Accounts payable	Tk.44,000	Tk.45,000
Bonds payable	235,000	265,000
Common stock	280,000	250,000
Retained earnings	142,140	200,540
	Tk.701,140	Tk.760,540

Additional information:

1. Operating expenses include depreciation expense of Tk.60,000 and charges from prepaid expenses of Tk.4,400.
2. Land was sold for cash at cost.

3. Cash dividends of Tk.105,290 were paid.
4. Net income for 2007 was Tk.46,890.
5. Equipment was purchased for Tk.65,000 cash. In addition, equipment costing Tk.40,000 with a book value of Tk.16,000 was sold for Tk.14,000 cash.
6. Bonds were converted at face value by issuing 30,000 shares of Tk.1 par value common stock.
7. Net sales in 2007 were Tk.36,700.

Instructions

(a) Prepare a statement of cash flows for 2007 using the indirect method.

(b) Compute free cash flow for 2007.

8. Balance sheet accounts for Prentice Company contained the following amounts at the end of years 1 and 2.

Prentice Company
Balance Sheets
December 31

Debit Balance Accounts	**Year 2**	**Year 1**
Cash	Tk.11,000	Tk.19,000
Accounts Receivable	250,000	180,000
Inventory	318,000	270,000
Prepaid Expenses	7,000	16,000
Loan to Harker Company	40,000	–
Plant and Equipment	620,000	500,000
Total Debits	**Tk.1,246,000**	**Tk.985,000**
Credit Balance Accounts		
Accumulated Depreciation	Tk.165,000	Tk.130,000
Accounts Payable	310,000	260,000
Accrued Liabilities	42,000	50,000
Bonds Payable	190,000	100,000
Deferred Income Taxes	84,000	80,000
Common Stock	335,000	275,000
Retained Earnings	120,000	90,000
Total Credits	**Tk.1,246,000**	**Tk.985,000**

The company's income statement for year 2 follows:

Sales	Tk.700,000
Less: Cost of Goods sold	400,000
Gross margin	300,000
Less: Operating Expenses	216,000

Net operating income	84,000
Gain on sale of equipment	6,000
Income before taxes	90,000
Less income taxes	27,000
Net Income	Tk.63,000

Instructions:

Equipment that had cost Tk.30,000 and on which there was accumulated depreciation of Tk.10,000 was sold during year 2 for Tk.26,000. Cash dividends totaling Tk.33,000 were declared and paid during year 2.

(i) Using the indirect method, compute the cash provided by operating activities for year 2.

(ii) Prepare a statement of cash flows for year 2.

(v) Prepare a brief explanation as to why cash declined so sharply during the year.

9. A comparative balance sheet and income statement for Simon Elvin Company follow:

Simon Elvin Company
Comparative Balance Sheets
December 31, 2007, and 2006

(Tk. in thousand)

	2007	**2006**
Assets		
Cash	Tk.4	Tk.11
Accounts Receivable	310	230
Inventory	160	195
Prepaid Expenses	8	6
Plant and Equipment	500	4200
Accumulated depreciation	(85)	(70)
Long-term investments	31	38
Total Assets	**Tk.928**	**Tk.830**
Liabilities and Stockholders' Equity		
Accounts Payable	Tk.300	Tk.225
Accrued Liabilities	70	80
Bonds Payable	195	170
Deferred Income Taxes	71	63
Common Stock	160	200
Retained Earnings	132	92
Total Liabilities and Stockholders' Equity	**Tk.928**	**Tk.830**

Simon Elvin Company
Income Statement
For the Year Ended December 31, 2007

		(Tk. in thousand)
Sales		Tk.750
Less: Cost of Goods sold		450
Gross margin		300
Less: Operating Expenses		223
Net operating income		77
Non-operating items:		
Gain on sale of equipment	Tk.5	
Loss on sale of equipment	2	3
Income before taxes		80
Less income taxes		24
Net Income		Tk.56

Instructions

During 19x5, the company sold some equipment for Tk.18 thousand that had cost Tk.30 thousand and on which there was accumulated depreciation of Tk.10 thousand. In addition, the company sold long-term investments for Tk.12 thousand that had cost Tk.7 thousand when purchased several years ago. Cash dividends totaling Tk.16 were paid during 2007.

(i) Using the indirect method, determine the cash provided by operating activities for 2007.

(ii) Use the information in (i) above, along with an analysis of the remaining balance sheet accounts, and prepare a statement of cash flows for 2007.

10. Sharon Feldman, president of Allied Products, considers Tk.20,000 to be a minimum cash balance for operating purposes. As can be seen from the statements below, only Tk.15,000 in cash was available at the end of 2007. Since the company reported a large net income for the year, and also issued bonds and sold some long-term investments, the sharp decline in cash is puzzling to Ms. Feldman.

Allied Products
Comparative Balance Sheets
December 31, 2007, and 2006

	19x2	**19x1**
Assets		
Current Assets:		
Cash	Tk.15,000	Tk.33,000
Accounts Receivable	300,000	210,000

Inventory	250,000	196,000
Prepaid Expenses	7,000	15,000
Total current assets	572,000	454,000
Long-term investments	90,000	120,000
Plant and equipment	860,000	750,000
Less accumulated depreciation	210,000	190,000
Net plant and equipment	650,000	560,000
Total Assets	**Tk.1,312,000**	**Tk.1,134,000**
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts Payable	Tk.275,000	Tk.230,000
Accrued Liabilities	8,000	15,000
Total Current Liabilities	**283,000**	**245,000**
Bonds Payable	200,000	100,000
Deferred Income Taxes	42,000	39,000
Total Liabilities	**525,000**	**384,000**
Stockholders' Equity:		
Common Stock	595,000	600,000
Retained Earnings	192,000	150,000
Total Stockholders' Equity	**787,000**	**750,000**
Total liabilities and stockholders' equity	**Tk.1,312,000**	**Tk.1,134,000**

Allied Products
Income Statement
For the Year Ended December 31, 2007

Sales		Tk.800,000
Less: Cost of Goods sold		500,000
Gross margin		300,000
Less: Operating Expenses		214,000
Net operating income		86,000
Non-operating items:		
Gain on sale of investments	Tk.20,000	
Loss on sale of equipment	6,000	14,000
Income before taxes		100,000
Less income taxes		30,000
Net Income		Tk.70,000

The following additional information is available for the year 2007.

(a) The company sold long-term investments with an original cost of Tk.30,000 for Tk.50,000 during the year.

(b) Equipment that had cost Tk.90,000 and on which there was Tk.40,000 in accumulated depreciation was sold during the year for Tk.44,000.

(c) Cash dividends totaling Tk.28,000 were declared and paid during the year.

(d) The stock of a dissident stockholder was repurchased for cash and retired during the year. No issues of stock were made.

Instructions:

(i) Using the indirect method, compute the cash provided by operating activities for 2007.

(ii) Using the data from (i) above and other data from the problem as needed, prepare a statement of cash flows for 2007.

(iii) Explain to the president the major reasons for the decline in the company's cash position.

11. Delux Company is a manufacturer of fine swords. Below are listed the net changes in the company's balance sheet accounts for the past year:

	Debits	**Credits**
Cash	Tk.51,000	
Accounts Receivable	170,000	
Inventory		Tk.63,000
Prepaid Expenses	4,000	
Long-term Loans to Subsidiaries		80,000
Long-term Investments	90,000	
Plant and Equipment	340,000	
Accumulated Depreciation		65,000
Accounts Payable		48,000
Accrued Liabilities	5,000	
Bonds Payable		200,000
Deferred Income Taxes		9,000
Preferred Stock	180,000	
Common Stock		300,000
Retained Earnings		75,000
	Tk.840,000	Tk.840,000

The following additional information is available about last year's activities:

(a) Net income for the year was Tk. _____?_____.

(b) The company sold equipment during the year for Tk.35,000. The equipment had cost the company Tk.160,000 when purchased, and it had Tk.1,45,000 in accumulated depreciation at the time of sale.

(c) The company declared and paid Tk.10,000 in cash dividends during the year.

(d) Depreciation charges for the year were Tk. ____?____.

(e) The opening and closing balances in the Plant and Equipment and Accumulated Depreciation accounts are given below:

	Opening	**Closing**
Plant and Equipment	Tk.2,850,000	Tk.3,190,000
Accumulated Depreciation	975,000	1,040,000

(f) There were no stock conversions (i.e., one class of stock converted to another class) during the year.

(g) The balance in the Cash account at the beginning of the year was Tk.109,000; the balance at the end of the year was Tk. ___?___.

(h) If data are not given explaining the change in an account, make the most logical assumption as to the cause of the change.

Instructions:

Using the indirect method, prepare a statement of cash flows for the year.

12. A comparative balance sheet for Alcorn Products containing data for the last two years is given below:

Alcorn Products
Comparative Balance Sheets
December 31, 2007, and 2006

	2007	**2006**
Current Assets:		
Cash	Tk.45,000	Tk.33,000
Marketable Securities	26,000	17,000
Accounts Receivable	590,000	410,000
Inventory	608,000	620,000
Prepaid Expenses	10,000	5,000
Total Current Assets	1,279,000	1,085,000
Long-term investments	80,000	130,000

The following additional information is available about the company's activities during 2007, the current year:

(a) Cash dividends declared and paid to the common stockholders totaled Tk.75,000.

(b) Long-term notes with a value of Tk.380,000 were repaid during the year.

(c) Equipment was sold during the year for Tk.70,000. The equipment had cost Tk.130,000 and had Tk.40,000 in accumulated depreciation on the date of sale.

(d) Long-term investments were sold during the year for Tk.110,000. These investments had cost Tk.50,000 when purchased several years ago.

The company reported net income during 2007 as follows:

Sales		Tk.3,000,000
Less cost of goods sold		1,860,000
Gross margin		1,140,000
Less operating expenses		930,000
Net operating income		210,000
Non-operating items:		
Gain on sale of investments	Tk.60,000	
Loss on sale of equipment	20,000	40,000
Income before taxes		250,000
Less income taxes		80,000
Net income		Tk.170,000

Instructions:

(i) Prepare a worksheet like Exhibit 17-10 for Alcorn Products.

(ii) Using the indirect method, prepare a statement of cash flows for the year.

(iii) What problems relating to the company's activities are revealed by the statement of cash flows that you have prepared?