

Financial Accounting
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Lecture – 105
7.15 Practice Problem (Part 1)

Time for a practice problem. In this video, I am going to use a practice problem from a textbook and prepare the cash flow statement. The purpose of this video is to help you go through the process, reiterate the process that is followed to prepare the cash flow statement. However, I am not going to elaborate too much on the reasons for different treatments done to different items because we have already done it.

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Prepare a Cash Flow Statement from following information


Liabilities	2019	2020	Assets	2019	2020
Share Capital	9,00,000	9,00,000	Fixed Assets	8,00,000	6,40,000
General Reserve	6,00,000	6,20,000	Investments	1,00,000	1,20,000
Profit & loss a/c	1,12,000	1,36,000	Stock	4,80,000	4,20,000
Creditors	3,36,000	2,68,000	Debtors	4,20,000	9,10,000
Provision for tax	1,50,000	20,000	Bank	2,98,000	3,94,000
Mortgage loan	-	5,40,000			
	20,98,000	24,84,000		20,98,000	24,84,000

Additional Information:

- ✓ Investments costing Rs.16,000 were sold during the year for Rs.17,000
- ✓ Provision for tax during the year Rs.18,000
- ✓ During the year, a part of the fixed assets costing Rs.20,000 was sold for Rs.24,000 and the profit was included in Profit and Loss account
4. Dividends paid amounted to Rs.8000

bank 13000
 To Investment 16000
 To Profit on Sale 1000

Bank 24000
 To FA 20000
 To Profit 4000



Source: P Periasamy, Financial Management, Tata McGraw Hill Education, 2ed

The purpose is to just do the preparation in one go to give you a better understanding of the cash flow statement preparation.

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Calculation of Cash Flows From Operating Activities	
Particulars	Amount
A. Calculation of Cash Flows From Operating Activities	
Increase in Profit & Loss Account during the year	24000
Add: Appropriation of profits (Dividend, Reserve)	
Add: Non Cash expenses and Non operating expenses	
Provision for tax made during the year	
Depreciation	
Preliminary expenses written off	
Interest paid on loan/ debentures	
Loss on sale of fixed assets	
Discount on issue of shares/debentures	
Less: Non Operating Revenues	
Interest / dividend received	
Profit on sale of fixed asset	
Tax paid	
Operating cash profit before working capital changes	



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Operating cash profits before working capital changes	
Add: Decrease in current assets	
Increase in current liabilities	
Less Increase in current assets	
Decrease in current liabilities	
Net Cash generated from operations	
Cash flows from (used in) operating activities (A)	
B. Calculation of Cash Flows From Investing Activities	
Add: Proceeds from sale of fixed assets	
Proceeds from sale of investments	
Proceeds from sale of intangible assets	
Interest and dividend received	
Less Purchase of fixed assets	
Purchase of investment	
Purchase of intangible assets like goodwill	
Rent Interest income	
Net cash from (or used in) investing activities (B)	



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C. Calculation of Cash Flows From Financing Activities

Add:	Proceeds from issue of shares and debentures		
	Proceeds from other long term borrowings		
Less:	Interest on debentures and loans paid		
	Dividends paid		
	Repayment of loans		
	Redemption of debenture / preference shares		
	Net cash from (or used in) financing activities (C)		
	Net Cash flow from/used during the year (A+B+C)		

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Working Notes

Unadjusted A/c			
Particulars	Amount	Particulars	Amount
To Balance b/d	100000	By bank	17000
To Profit on sale	1000		
To Bank A/c (Purchase)	36000	By bal old	110000
	<u>137000</u>		<u>137000</u>

I have the same format which we have been using for the cash flow statement and I have some slides with working notes. I have some account formats drawn and from the previous videos you should understand that we need to figure out hidden items, that is why I have these spaces here.

I am going to begin with the liability side. Let us first look at the direction of change. So, from 2019 to 20, I am going to look from left to right; the profit and loss account is going up by 24,000. So, this is the amount retained during the year, 24,000.


Then I am going to look at the adjustments, there is something related to investment, provision for tax, fixed assets and dividend. So, I am just going to prepare my working notes, to be very safe, to know all the hidden information and accordingly then move forward. So, I will prepare an investment account and provision for tax account.

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Working Notes

Provision for Tax

Particulars	Amount	Particulars	Amount
To Bank (Paid)	148,000	By Balance b/d	150,000
To Balance c/d	20,000	By P&L A/c	18,000
	<u>168,000</u>		<u>168,000</u>



So, this is investment account and I will also prepare a provision for tax account and I think there is something about the fixed asset, fixed assets account.


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Working Notes

FA A/c

Particulars	Amount	Particulars	Amount
To Balance b/d	800,000	By Bank	24,000
To Profit on Sale	4,000	By Depreciation (Bal Fig)	140,000
		By Balance c/d	640,000
	<u>804,000</u>		<u>804,000</u>

66,000
36,000
104



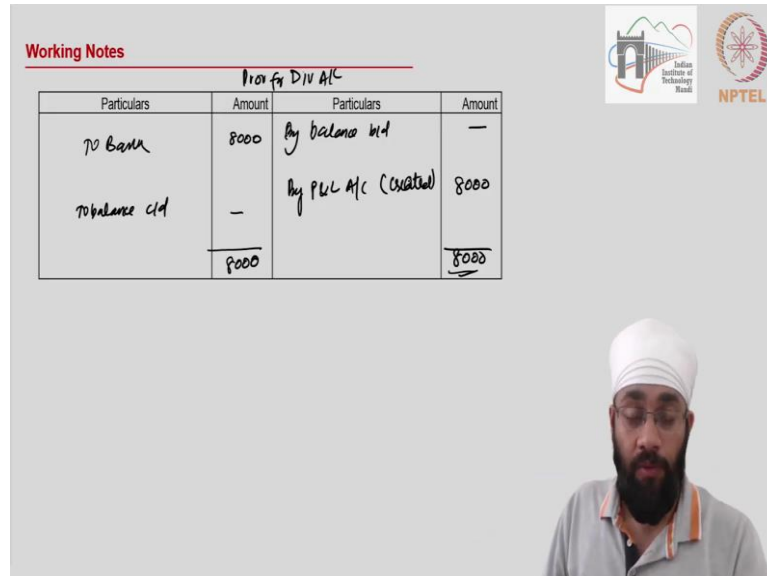
There is one last item which is dividend paid; however, there is no balance in the dividend account.

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Working Notes

Prov for Div A/c

Particulars	Amount	Particulars	Amount
To Bank	8000	By balance b/d	—
To balance c/d	—	By P&L A/c (created)	8000
	<u>8000</u>		<u>8000</u>



So, we are just going to regardless prepare a dividend account; provision for dividend account. Now, I am going to bring the balances to all these four accounts. Let us first focus on investment account. It is going to have an opening balance on the debit side, To Balance brought down and it will have a closing balance here By Balance carried down.

Likewise, provision for tax should start here By Balance brought down and To Balance carried down. The fixed asset will start on the debit side, To Balance brought down and By Balance carried down.

Provision for dividend will start on the credit side; By Balance brought down and To Balance carried down, alright. So, we are set to transfer the balances, the fixed assets were 8,00,000 and now they are 6,40,000. So, 6,00,000 to 8,00,000, 8,00,000 to 6,40,000 investments were 1,00,000, now they are 1,20,000.

Then you have provision for tax. Provision for tax was 150 and now it is only 20,000; 150 to 20,000 and you have dividend, but for dividend you do not have any provision for dividend account, you only have one piece of information which is about dividend paid.

So, we are going to keep it. Now, let us begin with the adjustments that we have, the additional information that we have been given. So, it says investments costing 16,000 were sold for

17,000. That means, the money has come in, Bank Account debit, To Investment. The money received is 17,000, the value of investment was only 16,000 that means, there is a profit on sale of 1,000 during the year.

So, in the investment account I am going to write By Bank 17,000 and there is a profit which is going to be written on the opposite side profit on sale of 1,000, that is it. There is no other information given about the investment account. So, I am going to just balance this. So, this comes out to be 1,01,000, no actually I have more balance on the opposite side. So, this comes out to be 1,37,000.

So, 1,37,000 minus 101,000 gives me 36,000 as the balancing figure. This is 137... Now this comes out to be a purchase of investment, To Bank account. So, we had 1,00,000 in the beginning and 120 at the end. There is a balancing figure, this is the purchase, this is the purchase of investment, done. Investment account is done.

I am going to then look at the next adjustment and also notice that this profit on sale also needs to be taken care of. So, we will do that when we start preparing the cash flow statement. Provision for tax, the provision made during the year is 18,000 alright. Provision made is written on this side by profit and loss account; 18,000 is the provision made. So, you have a total of 1,68,000 here; that means, there is a balancing figure on the debit side. So, To Bank, this is the actual tax paid during the year and this is 14,800 and 0 done. Let us look at the next adjustment which says during the year part of a fixed asset costing 20,000 was sold for 24,000 and the profit was included in the profit and loss account.

So, there is a sale of fixed assets during the year, the general entry is bank debit to fixed asset and you get 24,000 the value of the asset was 20 therefore, there is a profit on sale. So, in the fixed asset account I am going to write By Bank 24,000 and there is a profit to profit on sale which is 4,000, the value was 20,000 anyways that is correct. So, this is done as well. Do we have any information on depreciation?

Well not given here. So, no information on depreciation typically there would be depreciation on a fixed asset, but let us not temper with, let us not create artificial items here. So, we will not provide any depreciation. So, all we have to do now is to figure out the balance in this account which means this is 8,04,000 and this total comes out to be 6,00,000 this is 24. So, 6,64,000.

So, this gives me 36,000 to 7,00,000 and then 104,000 more. So, 1,40,000 is the balance and this comes out to be the depreciation. This is the balancing figure. So, during the year a piece of asset was sold for 24,000 and profit was made 4000. So, effectively 20,000 rupees worth of value went down.

So, you were left with only 7,80,000; however, the closing balance is 6,40,000, how can that be? That will be possible because there is an additional reduction in the value of fixed assets which is the depreciation and this is the balancing figure which has been figured out. So, this is new, the depreciation being the hidden information which we earlier did not have.

Let me just double check the calculation. This is 7,80,000 and 8,04,000 make sense this is correct and finally, we have the dividend the fourth item dividend paid is 8000 and here is a provision for dividend. Dividend paid means to bank 8000. There was no balance given in the beginning no balance given in the end, does not matter.

We are going to follow our process. 8000 is the total which means there is an item of 8000, what is this? This is the provision created during the year, this is the provision that you created during the year 8000.

Now, we have looked at all the adjustments which were required, we know what to do with these items, now we are going to just prepare the cash flow statement. I will stop here and continue this in the next video.