Financial Accounting
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Lecture – 99
7.11 Cash Flows from Financing Activities

In this video, we are going to discuss the third section in the Cash Flow Statement. This section deals with the financing activities of the business.

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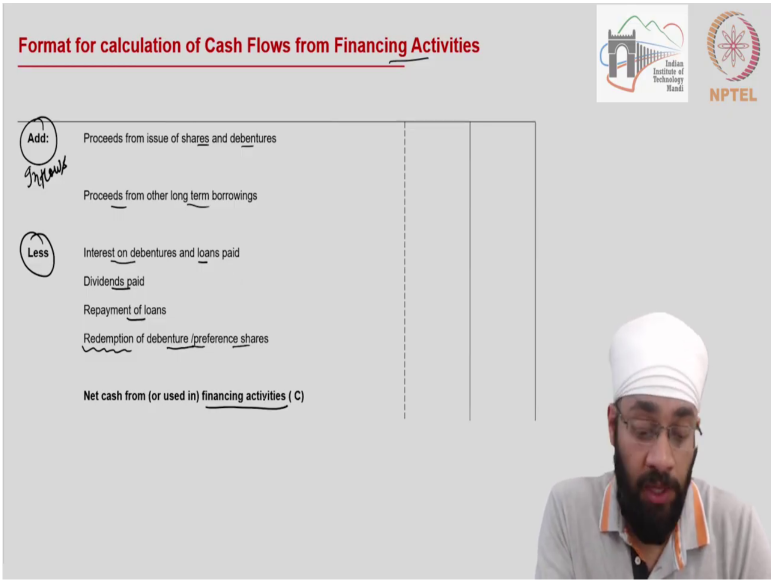

On the screen you see the template, the format, of the third subsection in the cash flow statement. The typical inflows in this subsection are from issue of shares or issue of debentures. There can be loans that are raised by the business, they also contribute to the inflows. So, when we are adding, we are referring to inflows which result from financing activities of the business.

So, financing activities, I discussed earlier as well, refer to the long term sources of funds particularly for the business and any expenses on servicing these liabilities are also considered under the financing activities head. So, interest that you pay on debentures or on the loans is also considered a financing activity. Dividends paid to the equity shareholders, or the preference shareholders or payment of EMIs on the loan or the principal amount payment, all that is shown in this subsection and redemption of any debentures or preference shares as well is shown. Preference shares have a timeline, have a deadline when they are redeemed, they are repaid. So, redemption essentially refers to repayment.

And, then you figure out the sum of all these activities. There are inflows and outflows. So, net what is the outcome: are you receiving cash from the financing activities or are you using cash in the financing activities?

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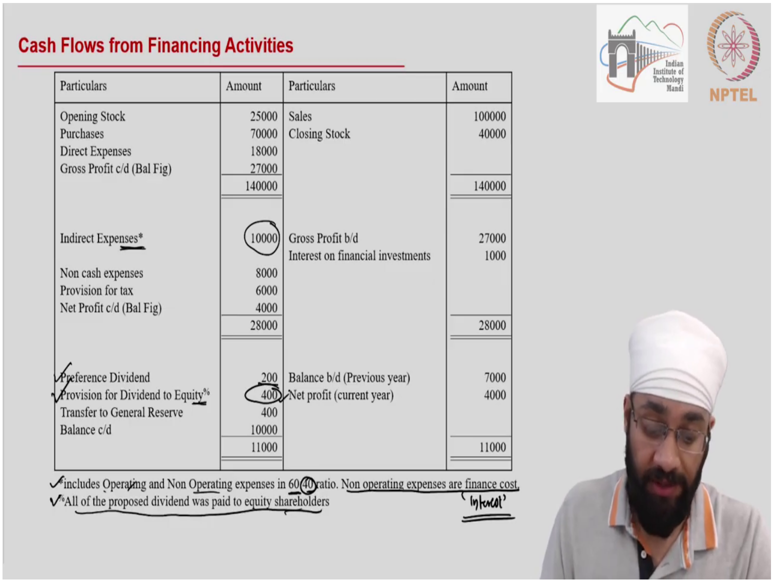

So, let us get started with the same income statement that we have been using and we have some additional information here. So, with respect to provision for dividend to equity, it says all the proposed dividend was paid to equity shareholders. It is just helping us understand the actual amount which was paid because we are dealing with a cash flow statement. So, provisions are essentially a non-cash item. So, we do not want to be confused between those two. Therefore, a clarification has been provided. All the other account balances in this statement are pretty much the same. I also have the same balance sheet with me which we have been using.

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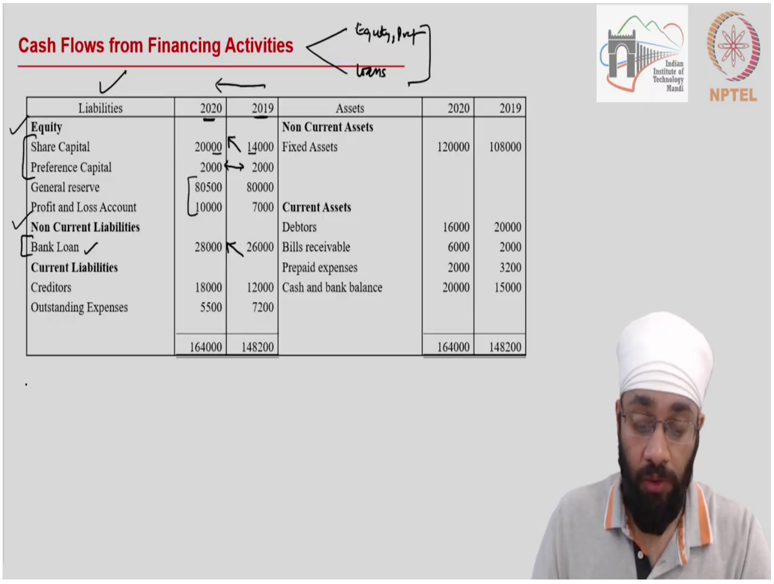

And, using the numbers from these two statements we are going to fill in this template. We are going to figure out the cash flows resulting from financing activities of the business. So, we are going to begin with the inflows. We have to look for any issue of shares or debentures first of all and shares and debentures are shown in the balance sheet.

So, I will go to the balance sheet and look for issue of shares if there is new capital that has been raised. The important point to notice is the 2019 previous year numbers are here and these are the current year numbers. So, this is the direction in which we should determine the change.

Share capital was 14,000 and now it is 20,000, it is going up; that means, more shares have been issued and against those shares which have been issued, the company must have received money income cash.

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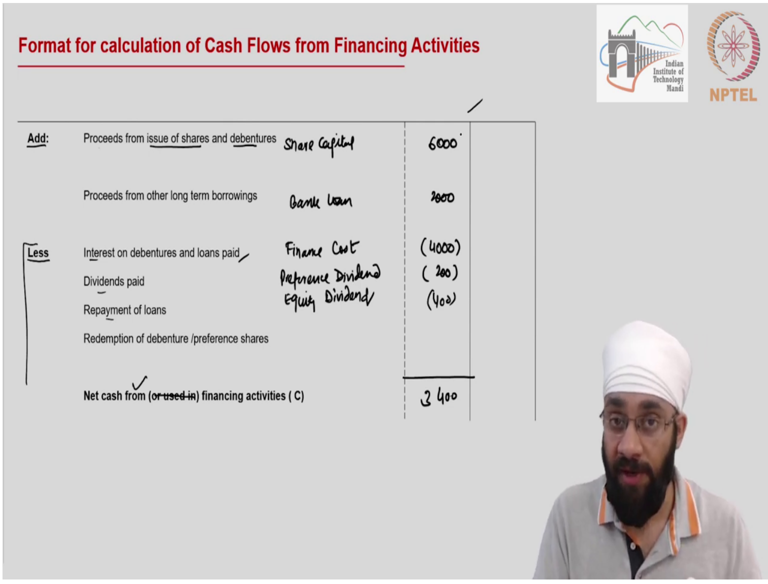

So, we are going to show 6000 as the proceeds from the issue of share capital. New share capital has been issued 6000. This is an inflow. Then you have preference capital. Preference capital was 2000 and now it is 2000 yet again, there is no change. New preference shares have not been issued; old preference shares have not been paid back.

Then you have a general reserve and profit and loss account, but these are appropriation of profit. They do not come under the financing activities. These are non cash accounts as well. So, we are going to ignore these. No need to worry about this. Then bank loan is also going up by 2000. So, this is a source of cash, bank loan is 2000. This is a source of cash for the business.

Current liabilities go to operating activities, we will not look at the current liabilities here. So, the first section is done. Now we have to look at the outflows from financing activities, have we paid interest, have we paid dividends, any repayments of loans? Let us look through the balance sheet first. From the balance sheet whatever was relevant we have already used that information; so, these two and bank loan.

Other than this there is no other information which deals with financing activities, because financing activities are related to the long term sources. And, long term funding sources include either the equity capital, the preference capital, or you will have loans or debentures and both these are going to be shown on the liability side and under equity head and noncurrent liabilities. So, you do not need to worry about looking elsewhere, at least in the balance sheet.

So, now we are looking for outflows. In the balance sheet there are no other hints on the outflows. Let us go to the income statement. In the income statement, this profit and loss accoun,t we have to look for dividends paid or interest paid. Now, non-cash expenses provision indirect expenses. So, in the indirect expenses here is a note. It includes operating and non-operating and non-operating expenses are finance cost.

Finance costs are the interest expenses that you pay on loans, on debentures. So, the 60 percent is operating and 40 percent is non-operating. So, 40 percent of 10,000 is 4000; 4000 is the finance cost. So, interest on debentures and loan 4000, this is finance cost, done. Let us go back. We are looking for any dividend speed and there is preference dividend of 200.

So, preference dividend is 200 and these are outflows. So, I am going to put these in parentheses. Then you have provision for dividend to equity shares, 400 and all the proposed dividend was paid to the equity shareholders. So, 400 is the actual payment made as well, another 400 paid. This is equity dividend, that is it.

And, then you have a transfer to the general reserve which we are not considering as far as financing activities are concerned and there is nothing else that should go to financing activities. So, all we have to do now is to sum these up and write the final number. So, this comes out to be 8000 and this is 8000 minus 4600, this is 3400.

This is the net cash from financing activities, not used, because there are more inflows and less outflows. So, from the financing activities the cash has come into the business during the year after considering all the financing activities. That is it.

I will see you in the next video.