

1

Kaizen Ltd. has prepared its Balance Sheet as at 31st March, 2023 and has current assets and current liabilities as follows:

Particulars	31st March, 2023 (₹)	31st March, 2022 (₹)
<b>Current Liabilities</b>		
Trade Payables	5,00,000	6,00,000
Other Current Liabilities (Advance for Sale of Goods)	2,00,000	1,00,000
Short-term Provisions (Provision for Tax)	1,00,000	50,000
<b>Current Assets</b>		
Trade Receivables	4,00,000	5,00,000
Inventories	5,00,000	4,50,000
Current Investments	2,00,000	...
Other Current Assets (Advance for purchase of Machineries)	5,00,000	...

The accountant is preparing Cash Flow Statement for the year ended 31st March, 2023 showing the above as follows:

#### CASH FLOW FROM OPERATING ACTIVITIES

Particulars	₹
<b>Change in Working Capital</b>	
<b>Add: Decrease in Current Assets and Increase in Current Liabilities</b>	
Other Current Liabilities (Advance against Sale of Goods)	1,00,000
Trade Receivables	1,00,000
Short-term Provisions (Provision for Tax)	50,000
<b>Less: Increase in Current Assets and Decrease in Current Liabilities</b>	
Inventories	50,000
Current Investments	2,00,000
Other Current Assets (Advance for Machineries)	5,00,000
Trade Payables	1,00,000

You have been asked following questions on the above:

- Whether the accountant has drawn the Cash Flow Statement (Change in Working Capital) correctly?
- If not, what are the errors committed by him? Why?

#### Answer

No, the accountant has not drawn the Cash Flow Statement correctly. The errors committed by him are as follows:

- Short-term provisions (Provision for Tax) is added to determine Net Profit before Tax and Extraordinary Items for the year and payment made is shown as outflow from Cash from Operations. Thus, by showing ₹ 50,000 as Change in Working Capital is an error committed by him.
- Current Investment is included in Cash and Cash Equivalents, since it is considered to have been invested for a period of three months or less and there is insignificant risk in change in its value.

2

Reliable Sales Ltd., had net profit of ₹ 10,00,000 for the year ended 31st March, 2023 after writing off Preliminary Expenses of ₹ 2,50,000; Share Issue Expenses of ₹ 2,00,000 and Underwriting Commission of ₹ 50,000.

What will be the treatment of the above items while preparing Cash Flow Statement for the year ended 31st March, 2023 and why?

**Answer**

- (a) No adjustment will be made for Preliminary Expenses of ₹ 2,50,000 because they are neither Investing Activity nor Financing Activity. Hence, it is Operating Activity.

It should be noted that preliminary expenses are written off in the year they are incurred.

*Definition of Operating Activities:* Operating Activities are the principal revenue producing activities of the enterprise and those activities which are not investing or financing activities.

- (b) Share Issue Expenses of ₹ 2,00,000 will be added to determine Net Profit for the year before Tax and Extraordinary Items. It will be shown as outflow under Financing Activity because they are expenses incurred for issue of shares.
- (c) Similarly, Underwriting Commission of ₹ 50,000 will be added to determine Net Profit for the year before Tax and Extraordinary Items. It will be shown as outflow under Financing Activity because they are expenses incurred for issue of shares.

3

Janhit Ltd. has presented following Note on Surplus, i.e., Balance in Statement of Profit & Loss for the year ended 31st March, 2023:

Particulars	₹	31st March, 2023 (₹)	₹	31st March, 2022 (₹)
<b>Debentures Redemption Reserve</b>				
Opening Balance	2,00,000	5,00,000	Nil	2,00,000
Add: Transferred from General Reserve	1,00,000		Nil	
Surplus, i.e., Balance in Statement of Profit & Loss	2,00,000		2,00,000	
<b>General Reserve</b>		Nil		6,00,000
Opening Balance	6,00,000		6,00,000	
Add: Transferred to Debentures Redemption Reserve	(1,00,000)		Nil	
Bonus Shares Issued	(5,00,000)		Nil	
<b>Surplus, i.e., Balance in Statement of Profit &amp; Loss</b>		5,00,000		5,00,000
Opening Balance	5,00,000		4,00,000	
Add: Net Profit for the year	6,00,000		5,00,000	
	11,00,000	5,00,000	9,00,000	5,00,000
Less: Dividend Paid	(4,00,000)		(2,00,000)	
Transfer to Debentures Redemption Reserve	(2,00,000)		(2,00,000)	
		10,00,000		13,00,000

You are to determine:

- (a) Net Profit before Tax and Extraordinary Activities for the year to calculate Cash Flow from Operating Activities.
- (b) State the amounts which shall not be shown in the Cash Flow Statement?
- (c) State which amounts shall be shown in Cash Flow Statement and under which Activity?

**Answer**

- (a) Net profit before Tax and Extraordinary Activities for the year is ₹ 6,00,000 (given in Surplus i.e., Balance in Statement of Profit & Loss. This may also be verified as follows:

Particulars	₹
<b>Net Profit before Tax and Extraordinary Activities for the year</b>	
Closing Balance of Surplus, <i>i.e.</i> , Balance in Statement of Profit & Loss	5,00,000
Less: Opening Balance	5,00,000
Balance	Nil
Add: Amount transferred to Debentures Redemption Reserve	2,00,000
Dividend Paid	4,00,000
Net Profit for the Year	6,00,000

- (b) Amounts that do not involve flow of Cash and Cash Equivalents shall not be shown in the Cash Flow Statement, which are
- (i) Transfer of amount from General Reserve to Debentures Redemption Reserve of ₹ 1,00,000; and
  - (ii) Issue of Bonus Shares of ₹ 5,00,000 by capitalising General Reserve.
- (c) Dividend Paid of ₹ 2,00,000 added to Net Profit for the year (as above) and shown as outflow under Financing Activities.