

# ICSE Class 12 Accounts – Chapter 4: Cash Flow Statement

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## ◆ Introduction

A **Cash Flow Statement** is a financial statement that shows the **inflows and outflows of cash and cash equivalents** in a business over a specific period. It helps assess the company's **liquidity, solvency, and financial flexibility**. Unlike the profit and loss account, which is prepared on an accrual basis, the Cash Flow Statement is purely based on **cash transactions**.

This chapter is crucial because it enables stakeholders to understand how a business generates and uses cash in **operating, investing, and financing** activities.

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## ◆ Objectives of Preparing Cash Flow Statement

- To assess the **cash generation and utilization** capacity of the enterprise.
  - To evaluate the ability of the business to **pay dividends, meet liabilities, and repay loans**.
  - To provide information about **changes in cash position** due to business activities.
  - To help in **financial planning and decision-making**.
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## ◆ Components of Cash Flow Statement

As per **AS-3 (Revised)** issued by the ICAI, cash flows are classified into three main categories:

### 1. Cash Flow from Operating Activities

These are the **main revenue-generating** activities of the enterprise, such as:

- Cash receipts from the sale of goods/services.
- Cash payments to suppliers and employees.
- Payments of taxes, duties, and other expenses.

There are two methods to compute it:

- **Direct Method**

- **Indirect Method** (more commonly used)

## 2. Cash Flow from Investing Activities

These are cash flows from the **acquisition and disposal of long-term assets** and investments:

- Purchase or sale of fixed assets.
- Purchase or sale of investments.
- Interest/dividends received (in some cases).

## 3. Cash Flow from Financing Activities

These include activities that cause **changes in the size and composition of owners' capital and borrowings**:

- Issue of shares or debentures.
- Repayment of borrowings.
- Payment of dividends and interest.

## ◆ Format of Cash Flow Statement (As per AS-3)

markdownCopyEditCash Flow from Operating Activities

Net Profit before Tax and Extraordinary Items

+ Adjustments for:

- Depreciation
- Loss on sale of fixed assets

+ Interest Paid

+ Operating Profit before Working Capital Changes

± Changes in Working Capital

- Cash generated from Operations

- Less: Income tax paid

= Net Cash Flow from Operating Activities (A)

Cash Flow from Investing Activities

- Purchase of Fixed Assets

+ Sale of Fixed Assets

+ Interest/Dividend received

= Net Cash Flow from Investing Activities (B)

Cash Flow from Financing Activities

+ Proceeds from issue of shares or debentures

- Redemption of debentures or repayment of loans

- Interest and Dividend paid

= Net Cash Flow from Financing Activities (C)

Net Increase/Decrease in Cash and Cash Equivalents = A + B + C  
Add: Cash and Cash Equivalents at the beginning  
= Cash and Cash Equivalents at the end

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## ◆ Methods of Calculating Operating Cash Flow

### ◆ Indirect Method (commonly used)

#### Steps:

1. Start with **Net Profit before Tax**.
  2. Add non-cash expenses like **depreciation, loss on sale of fixed assets**.
  3. Deduct non-operating incomes like **interest received, profit on sale of assets**.
  4. Adjust changes in **working capital** (Current Assets and Current Liabilities).
  5. Deduct **taxes paid**.
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## ◆ Key Adjustments in Cash Flow Statement

Particulars	Add / Less	Reason
Depreciation	Add	Non-cash expense
Loss on sale of assets	Add	Non-cash loss
Profit on sale of assets	Deduct	Non-operating income
Increase in Current Assets	Deduct	Use of cash
Decrease in Current Assets	Add	Source of cash
Increase in Current Liabilities	Add	Source of cash
Decrease in Current Liabilities	Deduct	Use of cash



## ◆ Solved Example

### Question:

From the following, calculate Net Cash Flow from Operating Activities:

- Net Profit before tax: ₹1,00,000
- Depreciation: ₹20,000
- Increase in Debtors: ₹10,000
- Decrease in Creditors: ₹5,000
- Tax paid: ₹25,000

### Solution:

Net Profit before Tax		₹1,00,000
Add: Depreciation	₹20,000	
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Operating Profit before Working Capital Changes	₹1,20,000	
Less: Increase in Debtors	₹10,000	
Less: Decrease in Creditors	₹5,000	
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Cash Generated from Operations	₹1,05,000	
Less: Tax Paid	₹25,000	
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Net Cash Flow from Operating Activities	₹80,000	

### ◆ Common Questions in Exams

1. What is a cash flow statement? State its objectives.
2. Name the three main categories of cash flow activities.
3. Distinguish between Direct and Indirect method.
4. Show the format of a cash flow statement.
5. Prepare a cash flow statement from given financial data.

### ◆ Summary

- The **Cash Flow Statement** is a crucial financial tool to track and evaluate cash inflows and outflows.
- It is divided into **Operating, Investing,** and **Financing** activities.
- The **Indirect Method** is widely used to calculate cash flow from operations.

- It assists stakeholders in understanding the **cash position, financial health,** and **operational efficiency** of the business.
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