4.11. TREATMENT OF BANK OVERDRAFT

In AS-3 there is no specific provision for bank overdraft but Ind AS-7 prescribes treatment for bank overdraft.

(1) Treatment as per AS-3 :

According to this standard, increase or decrease in bank overdrafts are usually considered as financing activity. Increase in bank overdraft will be shown as cash inflow from financing activity and decrease in bank overdraft as outflow of cash from financing activity.

As an alternative, it may be treated as a component of cash and cash equivalents which forms an integral part of an entity's cash management.

(2) Treatment as per Ind AS-7 :

As per Ind AS-7 : Statement of cash flow, **bank borrowings** are generally considered to be **financing activities**. But if the bank overdrafts, which are repayable on demand, form an integral part of an entity's cash management. In that case, bank overdrafts are included as component of cash and cash equivalents.

Illustration 3 : Debenture Interest, Unpaid Dividend and Bank Overdraft

From the following Balance Sheets of A Ltd. prepare Cash Flow Statement as per AS-3 (Revised).

Balance Sheets as on 31st March, 2018 and 31st March, 2019

Particulars	Note No.	31.03.2018 (₹)	31.03.2019 (₹)
I. EQUITY AND LIABILITIES			
1. Shareholders' Funds			
(a) Share Capital–Equity Share Capital		9,00,000	12,00,000
10% Preference Share Capital		6,00,000	3,00,000
(b) Reserve and Surplus -			
Surplus in Statement of Profit & Loss		3,30,000	8,25,000
Reserve		1,80,000	2,10,000
2. Non-current Liabilities			
(a) Long-term Borrowings–14% Debentures		3,00,000	4,50,000
3. Current Liabilities			
(a) Short-term Borrowings–Bank Overdraft		90,000	75,000
(b) Trade Payables - Creditors		60,000	2,25,000
(c) **Other Current Liabilities**			
Unpaid Dividend		—	30,000
Unpaid interest on Debentures		—	15,000
(d) **Short-term Provisions**			
Provision for tax		30,000	60,000
Provision for doubtful debts		30,000	45,000
Total		**25,20,000**	**34,35,000**
II. ASSETS			
1. Non-current Assets			
(a) Fixed Assets–Tangible		15,30,000	18,60,000

Particulars	Note No.	31.03.2018 (₹)	31.03.2019 (₹)
(b) **Non-Current Investments**			
10% Investment (Long-term)		90,000	2,40,000
2. Current Assets			
(a) Inventories–Stock		5,70,000	5,55,000
(b) Trade receivable – Debtors		1,20,000	2,25,000
(c) Cash and Cash Equivalents – Cash		1,80,000	5,40,000
(d) Other Current Assets			
Discount on issue of debentures		7,500	9,000
Underwriting commission		22,500	6,000
Total		**25,20,000**	**34,35,000**

Additional Information

(i) The provision for depreciation stood at ₹4,50,000 on 31.03.2018 and at ₹5,70,000 on 31.03.2019. A machine costing ₹2,10,000 (book value ₹1,20,000) was disposed off at a loss of 37.5%.

(ii) An interim dividend @15% was paid on equity shares, final dividend for the year ended 31st March, 2018, ₹1,80,000 was declared and paid during the year ended 31st March, 2019. New shares and debentures were issued on 31.03.2019.

(iii) Tax provided during the year was ₹45,000.

(iv) On 31.03.2019, some investments were purchased and some investments were sold for ₹1,50,000 at a profit of 25% on cost.

(v) Preference shares were redeemed on 01.04.2019 at a premium of 5%.

(vi) Treat Bank Overdraft as component of Cash and Cash Equivalents as it forms an integral part of the entity's cash management.

[Similar problem in C.U.B.Com (Hons.), 2019]

Solution :

Cash Flow Statement of X Ltd. for the year ended 31st March, 2019

Particulars	Amount (₹)	Amount (₹)
I. Cash Flows from Operating Activities		
Closing surplus of Statement of Profit & Loss	8,25,000	
Opening surplus of Statement of Profit & Loss	(3,30,000)	
Proposed dividend of last year declared during the year	1,80,000	
Interim dividend paid during the year	1,35,000	
Transfer to Reserves	30,000	
Provision for tax	45,000	
Increase in Provision for doubtful debts	15,000	
Net Profit before Taxation and Extraordinary Items	**9,00,000**	
Depreciation [W.N.2]	2,10,000	
Interest on long-term Borrowings [W.N.6]	42,000	
Underwriting commission written off [₹22,500 – ₹6,000]	16,500	

	Particulars	Amount (₹)	Amount (₹)
	Loss on sale of Machinery [W.N.3]	45,000	
	Premium payable on redemption of Preference Shares [W.N.5]	15,000	
	Interest income on investments [₹ 90,000 × 10%]	(9,000)	
	Profit on sale of investments [W.N. 3]	(30,000)	
	Operating profit before working capital changes	**11,89,500**	
	Decrease in stock [₹ 5,70,000 – ₹5,55,000]	15.000	
	Increase in creditors for goods [₹2,25,000 – ₹60,000]	1,65,000	
	Increase in debtors (gross) [₹ 2,25,000 – ₹1,20,000]	(1,05,000)	
	Cash generated from Operations	**12,64,500**	
	Income taxes paid (Net of refund) [W.N.4]	(15,000)	
	Net cash from Operating Activities		**12,49,500**
II.	**Cash Flows from Investing Activities**		
	Purchase of Machinery [W.N.1]	(6,60,000)	
	Proceeds from sale of machinery [W.N.1]	75,000	
	Purchase of Investments [W.N.3]	(2,70,000)	
	Proceeds from sale of Investment [W.N.3]	1,50,000	
	Interest received from investments [₹ 90,000 × 10%]	9,000	
	Net cash used in Investing Activities		**(6,96,000)**
III.	**Cash Flows from Financing Activities**		
	Proceeds from issue of Share Capital	3,00,000	
	Proceeds from Long-term Borrowings	1,48,500	
	Redemption of Preference Shares (₹3,00,000 + premium 5%)	(3,15,000)	
	Interest paid on 14% Debentures [W.N.6] (₹42,000 – unpaid interest ₹15,000)	(27,000)	
	Interim dividend paid during current year [₹9,00,000×15%]	(1,35,000)	
	Final dividend paid for the previous year (₹1,80,000 – unpaid dividend ₹30,000)	(1,50,000)	
	Net cash used in Financing Activities		(1,78,500)
IV.	**Net increase in Cash and Cash Equivalents (I+II+III)**		**3,75,000**
V.	**Cash and Cash Equivalents in the beginning**		
	Cash	1,80,000	
	Bank Overdraft*	(90,000)	90,000
VI.	**Cash and Cash Equivalents at the end of the period** [Cash – Bank Overdraft]* [₹5,40,000 – ₹75,000]		**4,65,000**

* As per question, Bank Overdraft has been treated as a component of Cash and Cash Equivalents. Bank Overdraft should be treated as a financial activity in the absence of any direction in the problem. So, as an alternative decrease in Bank Overdraft (₹90,000 – ₹75,000) = ₹15,000 can be treated as outflow of cash from Financing Activities.

Working Notes :

Dr. **(1) Fixed Assets A/c (At Cost)** Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/d ₹(15,30,000 + 4,50,000)	19,80,000	By Provision for Depreciation A/c ₹(2,10,000 – 1,20,000)	90,000
		By Bank A/c-Sale $\left(₹1,20,000 \times \frac{62.5}{100}\right)$	75,000
		By Loss on Sale of Fixed Assets A/c ₹(1,20,000 – 75,000)	45,000
To Bank A/c- (Balancing figure)	6,60,000	By Balance c/d ₹(18,60,000 + 5,70,000)	24,30,000
	26,40,000		26,40,000

Dr. **(2) Provision for Depreciation A/c** Cr.

Particulars	(₹)	Particulars	(₹)
To Fixed Assets A/c	90,000	By Balance b/d	4,50,000
		By Depreciation A/c (Balancing figure)	2,10,000
To Balance c/d	5,70,000		
	6,60,000		6,60,000

Dr. **(3) 10% Investment A/c** Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/d	90,000	By Bank A/c	1,50,000
To Profit on Sale of Investments A/c (₹1,50,000–₹1,50,000×$^{100}/_{125}$)	30,000		
To Bank A/c (balancing figure)	2,70,000	By Balance c/d	2,40,000
	3,90,000		3,90,000

Dr. **(4) Provision for Tax A/c** Cr.

Particulars	(₹)	Particulars	(₹)
To Bank A/c - Tax paid (Balancing figure)	15,000	By Balance b/d	30,000
		By Profit & Loss A/c– Provision made	45,000
To Balance c/d	60,000		
	75,000		75,000

(5) In this problem, it is assumed that premium payable on redemption of preference shares must have been written off to Profit & Loss A/c.

(6) Interest on Debentures @14% on ₹3,00,000 will be added to Net Profit for finding out Cash from Operating Activities as it is Non-operating Expenses.

(7) Interest paid i.e. Due Unpaid i.e. ₹42,000 – ₹15,000 = ₹27,000 will be shown as cash outflow under Financing Activities.

4.12. TREATMENT OF SOME PECULIAR ITEMS IN CASH FLOW STATEMENT AS PER AS-3

4.12.1 Extraordinary Items

Extraordinary items are those items which are not regular phenomenon like earthquake, flood, theft etc., Extraordinary items are non-recurring in nature, and therefore, cash flows associated with extraordinary items should be classified and disclosed separately as arising from operating, investing or financing activities in the cash flow statement. This is done so that users can understand their nature and effect on the present and future cash flows of an enterprise.

Example :

(1) Compensation paid to workmen for heavy amount is operating activity (outflow).

(2) Insurance claim received from insurance company on–

- Loss of goods is inflow of cash from Operating Activity
- Loss of fixed assets is inflow of cash from Investing Activity.

(3) Law suit compensation received for supplying defective goods by supplier is Operating Activity.

(4) In riots, there may be sabotage to building and as a result, any compensation received from Government for such loss is considered as Investing Activity.

Points to Remember :

- Loss on sale of fixed assets or sale of machinery is not an extraordinary item.
- For presentation of extraordinary items there is no corresponding provision in Ind AS-7.

4.12.2 Interest And Dividend

AS-3 prescribes the following treatment as regards interest and dividend for fianancial enterprise (whose main business is lending and borrowing) and non-financial enterprise.

	Financial Enterprise	Non-Financial Enterprise
Interest paid	Operating Activity	Financing Activity
Interest and dividend received	Operating Activity	Investing Activity
Dividend paid	Financing Activity	Financing Activity

4.12.3 Taxes On Income And Gains

Taxes may be income tax (tax on normal profit), capital gains tax (tax on capital profits), dividend tax (tax on the amount distributed as dividend to shareholders). AS-3 requires that 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. This clearly implies that :

- Tax on operating profit should be classified as operating cash flows.

- Dividend tax, i.e., tax paid on dividend should be classified as financing activity along with dividend paid.
- Capital gains tax paid on sale of fixed assets should be classified under investing activities.

4.12.4 Non-Cash Transactions

As per AS-3, investing and financing transactions that do not require the use of cash or cash equivalents should be excluded from a cash flow statement. Examples of such transactions are– acquisition of machinery by issue of equity shares or redemption of debentures by issue of equity shares. Such transactions should be disclosed elsewhere in the financial statements in a way that provide all the relevant information about these investing and financing activities. The exclusion of non-cash transactions from cash flow statement is consistent with the objectives of cash flow statement because these non-cash transactions do not involve cash flows in the current period. Hence, assets acquired by issue of shares are not disclosed in cash flow statement due to non-cash nature of the transaction.

4.13. TREATMENT OF SPECIAL ITEMS IN CASH FLOW STATEMENT

There are certain special items for which accounts are to be prepared as a part of working notes for calculation of hidden information at the time of preparation of cash flow statement. These items are as follows :

(1) Provision for Taxation :

On the basis of self-assesssment a company determines its tax liability and such tax is charged against profits. In this context the following account is to be prepared :

Dr. **Provision for Tax A/c** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Bank A/c– Actual tax paid	XXX	01.04 By Balance b/d (Opening provision)	XXX
31.03 To Balance c/d	XXX	31.03 By Profit and Loss A/c (Provided) (Balancing fig.)	XXX
	XXX		XXX

(2) Treatment of Interim Dividend

When interim dividend is declared :

Profit and Loss A/c .... Dr.
To Interim Dividend A/c

When paid

Interim Dividend A/c .... Dr.
To Bank A/c

So the amount of Interim Dividend is to be shown in the debit side of Adjusted Profit and Loss A/c or Profit and Loss (Appropriation) A/c for calculation of Operating Profit before Working Capital changes in the cash flow statement. Interim Dividend paid in an accounting year is shown as **outflow of cash from financial activity**.

(3) Treatment of Proposed Dividend

● Before financial year 2016-17

The following account is prepared for this purpose :

Dr. **Proposed Dividend A/c** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
During the period	To Bank A/c (last year's dividend paid this year– unclaimed dividend	XXX (a)	Opening	By Balance b/d (As per previous year's Balance Sheet)	XXX (a)
	To Unclaimed Dividend	XXX (c)			
Closing date	To Balance c/d (As per current year's Balance Sheet)	XXX (d)	Closing date	By Profit & Loss A/c	XXX(b)
		XXX			XXX

● It means Opening Balance of Proposed Dividend which appears in the previous year's balance sheet is assumed to have been declared and paid during current year, unless the question mentions that a part the amount is still unpaid.

Proposed Dividend

01.04.2018

Starting of financial year

31.03.2019

Board of Directors recommends dividend based on estimated profit

AGM
30.09.2019

AGM should be held before 30.09.2019. Say, AGM held on 01.09.2019. In AGM on the basis of audited Balance Sheet, shareholders declare dividend which should not be more than dividend recommended by Board of Directors.

- The closing balance of Proposed Dividend is the dividend recommended by the Board of Directors in the current year.
- If unpaid dividend is given then, it should be deducted from previous year's proposed dividend to find out the net dividend paid.

Treatment of Proposed Dividend w.e.f. financial year 2016-17 as per Revised AS-4

Board of Directors recommends the rate or the amount of proposed dividend on 31st March of the financial year on the basis of estimated profit because audited accounts are not prepared on 31st March of the financial year. In the Annual General Meeting which is generally held before 30th September every year, shareholder declares dividend on the basis of audited Balance Sheet and Statement of Profit and Loss which should not be more than dividend recommended by Board of Directors on 31st March of the financial year.

Proposed dividend is not a liability and it does not fit into the definition of liability. In addition, proposed dividend is an estimated amount. So it cannot be treated as a liability unless the same is passed by the shareholders in the Annual General Meeting. So Proposed Dividend w.e.f. financial year 2016-17 is not to be recognized as a liability at the balance sheet date as per *Revised AS-4 Contigencies and Events Occurring After the Balance Sheet Date*. Rather, it should be disclosed in the Notes to Accounts as a Contingent Liability.

In the next financial year when dividend is declared by the shareholders in the Annual General Meeting then the following entry is passed.

Profit and Loss Adjustment/Appropriation A/c ..... Dr

To Dividend Payable A/c

Dividend Payable Account is prepared as follows:

Dr. **Dividend Payable A/c** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Bank A/c (balancing figure)	XXX	By Balance b/d (Opening balance of unpaid dividend)	XXX
To Balance c/d (Closing balance of unpaid dividend)	XXX	By Profit and Loss Adjustment A/c (Proposed dividend of previous year which was declared in the current year)	XXX
	XXX		XXX

Treatment in Cash Flow Statement

Dividend paid in an accounting year is shown as outflow of cash from financing activity in the cash flow statement.

Which method to follow?

If Proposed Dividend appears in the Balance Sheet then follow the old method. But if the Proposed Dividend appears in the Notes to Account section of the Balance Sheet as a Contigent Liability then follow the new method.

After financial year 2015-16 and w.e.f. financial year 2016-17 if proposed dividend is given in Balance Sheet then it means wrong entry has been passed. Because as per AS-4 (Revised), proposed dividend should not be given in the Balance Sheet. For this purpose to cancel the wrong entry reverse entry is to be passed as shown in illustraion.

Illustration 4 : Proposed Dividend given in the Balance Sheet and not in the Notes to Accounts as a contingent Liability – Rectification entry

The following are the Equity, Liabilities and Assets of XYZ Ltd. as on 31st March, 2018 and 2019.

Balance Sheets as at 31.03.2018 and 31.03.2019

Particulars	Note No.	31.03.2018 (₹)	31.03.2019 (₹)
I. EQUITY AND LIABILITIES :			
1. Shareholders' Funds :			
(a) Share Capital– Equity Shares of ₹10 each		40,00,000	50,00,000
(b) **Reserve & Surplus**			
Capital Reserve		—	40,000
General Reserve		10,00,000	12,00,000
Surplus in the Statement of Profit and Loss		6,00,000	7,20,000
2. Non-Current Liabilities :			
(a) Long-term Borrowings–Term loan		20,00,000	16,00,000
3. Current Liabilities :			
(a) **Trade Payables**			
Sundry Creditors		20,00,000	16,00,000
(b) **Short-term Provisions**			
Proposed Dividend		4,00,000	5,00,000
Provision for tax		2,00,000	2,40,000
Total		**1,02,00,000**	**1,09,00,000**
II. ASSETS :			
1. Non-Current Assets :			
(a) **Fixed Assets–Tangible Assets**			
Land & Building		20,00,000	19,20,000
Machinery		30,00,000	36,80,000
(b) **Non-Current Investments**		4,00,000	2,00,000
2. Current Assets :			
(a) Inventories (Stock)		12,00,000	11,20,000
(b) **Trade Receivables**			
Sundry Debtors		16,00,000	16,80,000
(c) **Cash and Cash Equivalents**			
Cash in hand		8,00,000	6,60,000
Cash at Bank		12,00,000	16,40,000
Total		**1,02,00,000**	**1,09,00,000**

Additional Information :

(1) Income tax provided during the year ₹2,20,000.
(2) Dividend of ₹4,00,000 was paid during the year ended 31st March, 2019.
(3) The company sold some investment at a profit of ₹40,000 which was credited to Capital Reserve.
(4) During the year, company purchased machinery for ₹9,00,000. The company paid ₹5,00,000 in cash and issued 40,000 equity shares of ₹10 each.
(5) There was no sale of machinery during the year.
(6) Depreciation written off on Land and Building ₹80,000.
(7) Ignore Corporate Dividend Tax.

Prepare a Cash Flow statement for the year ended 31st March, 2019 as per AS-3 (Revised) using Indirect Method. **[C.U.B.Com (Hons.), 2018]**

Working Notes :

(1) Calculation of Net profit before tax

Particulars		₹	₹
	Closing balance of surplus in Statement of Profit and Loss		7,20,000
Add:	Proposed dividend of current year wrongly adjusted		5,00,000
			12,20,000
Less:	Opening balance of surplus in Statement of Profit and Loss	6,00,000	
	Add: Proposed dividend of previous year wrongly adjusted	4,00,000	10,00,000
			2,20,000
Add:	Transfer to General Reserve (₹12,00,000 – ₹10,00,000)	2,00,000	
Add:	Provision for taxation [W.N. : 2]	2,20,000	
Add:	Proposed dividend of 2017-18 recommended on 31.03.2018 and adjusted as per AS-4 (Revised) after declaration of dividend by shareholders from surplus in Statement of Profit and Loss in the current year 2018-19	4,00,000	8,20,000
	Net Profit before Tax		10,40,000

Dr. **(2) Provision for Tax A/c** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Bank A/c (balancing fig.)	1,80,000	By Balance b/d	2,00,000
		By Profit and Loss A/c	2,20,000
To Balance c/d	2,40,000		
	4,20,000		4,20,000

Dr. **(3) Dividend Payable A/c** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Bank A/c	4,00,000	By Profit and Loss Adjustment/Appropriation A/c	4,00,000
	4,00,000		4,00,000

Dr. **(4) Land and Building A/c** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	20,00,000	By Depreciation A/c (bal. fig.)	80,000
		By Balance c/d	19,20,000
	20,00,000		20,00,000

Dr. **(5) Machinery A/c** **Cr.**

Particulars	(₹)	Particulars	(₹)
To balance b/d	30,00,000	By Depreciation A/c (bal. fig.)	2,20,000
To Equity share capital A/c	4,00,000		
To Bank A/c	5,00,000		
		By Balalnce c/d	36,80,000
	39,00,000		39,00,000

Dr. **(6) Investments A/c** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	4,00,000	By Bank A/c (bal. fig.)	2,40,000
To Capital Reserve A/c	40,000		
		By Balance c/d	2,00,000
	4,40,000		4,40,000

Dr. **(7) Equity Share Capital A/c** **Cr.**

Particulars	(₹)	Particulars	(₹)
		By Balance b/d	40,00,000
		By Machinery A/c	4,00,000
To Balance c/d	50,00,000	By Bank A/c – Issue (Bal fig.)	6,00,000
	50,00,000		50,00,000

Solution :

CASH FLOW STATEMENT AS PER AS-3 (REVISED) OF XYZ LTD.
for the year ended 31st March, 2019

Particulars		Amount (₹)	Amount (₹)
I. Cash Flows from Operating Activities			
Net Profit before tax [W.N.:1]		10,40,000	
Add: **Non–cash and Non-operating items**			
Depreciation on Land and Building [W.N. 4]		80,000	
Depreciation on Machinery [W.N.5]		2,20,000	
Operating profit before Working Capital Changes		**13,40,000**	
Working Capital Changes			
Add: **(1) Decrease in Non-cash Current Assets**			
Stock (₹ 12,00,000 – ₹ 11,20,000)	80,000		
(2) **Increase in current Liabilities**	—	80,000	
		14,20,000	
Less: **(1) Increae in Non-cash Current Assets**			
Debtors (₹ 16,80,000 – ₹ 16,00,000)	80,000		
(2) **Decrease in Current Liabilities**			
Creditors			
(₹ 20,00,000 – ₹ 16,00,000)	4,00,000	4,80,000	
Cash generated from Operations		9,40,000	
Less: Income tax paid		1,80,000	
Net cash from Operating Activities			**7,60,000**
II. Cash flows from Investing Activities			
Sale of Investment [W.N.:6]		2,40,000	
Less: Purchase of Machinery		5,00,000	
Net cash used in Investing Activities			**(2,60,000)**
III. Cash Flows from Financing Activities			
Proceeds from issue of Equity Shares [W.N.:7]		6,00,000	
Less: Payment of dividend [W.N.:3]		(4,00,000)	
Repayment of Term Loan			
(₹ 20,00,000 – ₹ 16,00,000)		(4,00,000)	
Net cash from Financing Activities			**(2,00,000)**
IV. Net increase/decrease in Cash and Cash Equivalents			**3,00,000**
Add: Opening cash and cash Equivalents			
(₹ 8,00,000 + ₹ 12,00,000)			20,00,000
Closing Cash and Cash Equivalents			**23,00,000**

4.14. INTERPRETATION OF CASH FLOW ANALYSIS ON THE BASIS OF RATIOS

Ratios to be used for the purpose of interpretation of cash flow statement :

(A) Coverage Ratios

(i) Interest Coverage Ratio $= \dfrac{\textbf{OCF + tax}}{\textbf{Interest}}$