

## ANSWERS

### 1. MULTIPLE CHOICE QUESTIONS

1. (4) **Explanation:** Cash Flow Statement is a statement that shows the cash flows (both inflow and outflow) of Cash and Cash Equivalents during two Balance Sheet dates under Operating, Investing and Financing Activities.
2. (1) **Explanation:** AS-3, Cash Flow Statement defines cash as cash comprises of Cash on Hand and Demand Deposits with Banks.
3. (2) **Explanation:** Cash Flow arises when the net effect of a transaction either increases or decreases the amount of Cash and Cash Equivalents.
4. (4) **Explanation:** All entries (items) except Bills of Exchange are included in Cash and Cash Equivalents.
5. (4) **Explanation:** All other entries (items) given except Cash Receipt from Royalties will result in flow of cash. Remaining entries (items) are movement in between the items of Cash and Cash Equivalents.
6. (1) **Explanation:** Cash Inflow arises when net effect of transaction is increase in the amount of Cash and Cash Equivalents.
7. (4) **Explanation:** Cash Outflow arises when decrease in the amount of Cash and Cash Equivalents is more than the increase in the amount of Cash and Cash Equivalents.
8. (2) **Explanation:** Underwriting commission paid will result into outflow of cash, not inflow.
9. (4) **Explanations:** Loan taken will result in inflow of cash. Issue of Debentures as collateral Security against the loan taken will not result in inflow of cash.
10. (4) **Explanation:** Cash Equivalents are short-term, highly liquid investments that are readily convertible into known amount of cash and which are subject to an insignificant risk of change in value. Deposit in bank for a period of two months is convertible into known amount of cash without there being significant change in value. Thus, it will be Cash and Cash Equivalent.
11. (3) **Explanation:** The objectives of Cash Flow Statement are to determine sources (receipts), applications (payments) and net change in Cash and Cash Equivalents under Operating, Investing and Financing Activities between the dates of two Balance Sheets.
12. (4) **Explanation:** Net Change in Cash and Cash Equivalents is the difference between sources (a) and applications (b) under Operating, Investing and Financing Activities between the dates of two Balance Sheets.
13. (3) **Explanation:** All other items except Premium on Redemption of Debentures are expenses or losses that may have been shown as an expense or loss for the year. Thus, they are added to Net Profit before Tax while computing Cash Flow from Operating Activities. Premium on Redemption of Debentures is a liability and shown in the Balance Sheet.
14. (1) **Explanation:** All other entries (items) except Commission Received are inflows from Investing Activities. Commission received is an Operating Activity.
15. (4) **Explanation:** All other entries (items) except Purchase of Goodwill are inflows or outflows from Operating Activities. Purchase of Goodwill is an outflow under Investing Activities.
16. (2) **Explanation:** All entries (items) except purchase of Marketable Securities are Investing Activities.
17. (1) **Explanation:** All entries (items) except interest on Bank overdraft, do not involve flow of cash.
18. (2) **Explanation:** Premium on Redemption of Debentures (being a liability) is payable when debentures are redeemed, loss arising (*i.e.*, Loss on Issue of Debentures) on issue of debentures because of premium payable at the time of redemption is provided at the time of issue of Debentures following Prudence Concept. Loss on Issue of Debentures is written off from Securities Premium Reserve and/or from Capital Reserve and/or from Statement of Profit & Loss.  
Thus, Premium on Redemption of Debentures is not added to Net Profit before Tax and Extraordinary Items to arrive at Operating Profit before Working Capital Changes.
19. (4) **Explanation:** All entries (items) except brokerage received from clients are not Operating Activities.
20. (4) **Explanation:** None of the entries (items) are classified as Financing Activities except dividend paid to the shareholders. Remaining entries (items) fall under Investing Activities.

21. (4) **Explanation:** Refund of Tax is shown in the credit of Statement of Profit & Loss. As a result, net profit is higher. Therefore, it is deducted for determining Net Profit before Tax and Extraordinary Items.
22. (3) **Explanation:** Insurance claim received is deducted from Profit (*i.e.*, difference between Surplus, *i.e.*, Balance in Statement of Profit & Loss) while computing Net Profit before Tax and Extraordinary Items. All other entries (items) are added to net profit to determine Net Profit before Tax and Extraordinary Items.
23. (1) **Explanation:** None of the entries (items) except preliminary expenses are added to profit (*i.e.*, difference between Closing and Opening balances in Surplus, *i.e.*, Balance in Statement of Profit & Loss) for determining Net Profit before Tax and Extraordinary Items. Preliminary expense is added because it is written off from Statement of Profit & Loss. All other entries (items) are written off from Securities Premium or Capital Reserve. Since it is not considered for determining net profit, they are not added to determine Net Profit before Tax and Extraordinary Items.
24. (1) **Explanation:** Sum of Cash Flows from all activities (*i.e.*, Operating, Investing and Financing) and Opening balance of Cash and Cash Equivalents will be equal to Closing balance of Cash and Cash Equivalents.
25. (4) **Explanation:** Payment of Salaries and Bonus are always shown or classified as Operating Activity by both Financing and Non-financing Companies since they are incurred for running the operations.
26. (1) **Explanation:** Since Share Capital is shown as financing activity, dividend paid is shown as Financing Activity by both Financing and Non-financing Companies.
27. (3) **Explanation:** AS-3, Cash Flow Statement defines investment to qualify as Cash Equivalent if it meets two conditions, *i.e.*, (i) It has a short maturity period of, say, 3 months or less from the date of acquisition; and (ii) it is subject to an insignificant risk of change in value.
28. (4) **Explanation:** Payment for purchase of an asset, (Machinery, in this case) under Hire-Purchase System. The instalment has two components, *i.e.*, principal and interest. Thus, Principal paid (₹ 22,728) is shown as an Investing Activity while Interest paid (₹ 2,272) is shown as Financing Activity.
29. (4) **Explanation:** Non-cash transactions do not involve cash and cash equivalents hence, are not shown in Cash Flow Statement. Movement in between Cash and Cash Equivalents are not shown in Cash Flow Statement because it is change in one component to another of Cash and Cash Equivalents.
30. (2) **Explanation:** Goodwill amortised being a non-cash expense is added to Net Profit before Tax and Extraordinary Items to determine Cash Flow from Operating Activities. It is added because non-cash expenses and losses debited in Statement of Profit & Loss do not affect Cash Flow.
31. (3) **Explanation:** Non-cash expenses and losses are added to Net Profit before Tax and Extraordinary Items because they do not result in outflow of cash.
32. (2) **Explanation:** Profit of ₹ 8,72,000 earned for the current year is the Cash Flow from Operating Activities since no adjustment is to be made to net profit for the year.

33. (3) **Explanation:** *It is calculated as follows:*

Net Profit as per difference between Closing and Opening Balance of Surplus, <i>i.e.</i> , Balance in Statement of Profit & Loss (₹ 5,60,000 – ₹ 2,00,000)	₹ 3,60,000
Add: Transfer to General Reserve (₹ 1,20,000 – ₹ 1,00,000)	20,000
Dividend Paid (Proposed for the year ended 31st March, 2021)	60,000
Interim Dividend Paid	<u>40,000</u>
Net Profit before Tax and Extraordinary Items	<u>4,80,000</u>

34. (1) **Explanation:** *It is calculated as follows:*

Net Profit as per Difference between Closing and Opening Balance of Surplus, <i>i.e.</i> , Balance in Statement of Profit & Loss [₹ 3,60,000 – (– ₹ 60,000)]	₹ 4,20,000
Add: Transfer to General Reserve (₹ 2,20,000 – ₹ 1,60,000)	60,000
Dividend Paid (Proposed for the year ended 31st March, 2021)	80,000
Provision for Tax	<u>40,000</u>
	6,00,000
Less: Refund of Tax	<u>2,500</u>
	5,97,500
Add: Extraordinary Item debited as Expense (Loss of Inventory by Fire)	<u>80,000</u>
	6,77,500
Less: Extraordinary Item credited as Income (Insurance claim received)	<u>60,000</u>
Net Profit before Tax and Extraordinary Items	<u>6,17,500</u>

35. (3) **Explanation:** Purchase of Plant and Equipment on Deferred Payment Basis and purchase of machinery for consideration other than cash are not shown in Cash Flow Statement as there is no outflow of cash. Decrease in Goodwill means it has been amortised meaning it is a non-cash expense. Payment towards purchase of license is an expense towards operating the business and therefore, is shown as Investing Activities.
36. (3) **Explanation:** Issue of Bonus Shares, Redemption of Fully Convertible Debentures at par and Issue of Shares against purchase of Machinery are non-cash items since there is no flow of cash. Thus, they are not shown as Financing Activity. Proceeds from issue of debentures results in inflow of cash and are shown as financing activity.
37. (3) **Explanation:** Conversion of Debentures into Shares, Issue of Shares for consideration other than cash and Receipt of Dividend Receivable are not shown as Financing Activities as conversion of debentures and issue of shares for consideration other than cash do not result in flow of cash while Receipt of Dividend Receivable is shown as inflow under Cash Flow from Investing Activities.
- Underwriting Commission is financing activity since it is paid for underwriting the issue of shares/debentures.
38. (1) **Explanation:** For a non-finance company, purchase of stock-in-trade, incurrence of selling and distribution expenses and sale of its products are classified as Operating Activities, they being the principal revenue producing activities.
39. (2) **Explanation:** Buy Back of Own Shares is Outflow associated with purchase of own shares and therefore it is shown under Cash Flow from Financing Activities.
40. (2) **Explanation:** Decrease in Current Assets and Increase in Current Liabilities are added to Operating Profit before Working Capital Changes to determine Cash Generated from Operations because it results in increase in inflow of cash and cash equivalents.
41. (1) **Explanation:** Increase in Current Assets and Decrease in Current Liabilities are deducted from Operating Profit before Working Capital Changes to determine Cash Generated from Operations because it results in outflow of cash and cash equivalents.
42. (2) **Explanation:** Loss on Issue of Debentures is added to Net Profit before Tax and Extraordinary Items while computing Operating Profit before Working Capital Changes while the remaining are not added.
43. (2) **Explanation:** While computing Cash Flow from Operating Activities, transfer to Provision for Doubtful Debts and Sale Proceeds of Machinery are not deducted, if starting point is Surplus, *i.e.*, Balance in Statement of Profit & Loss.
44. (2) **Explanation:** Declaration of Interim Dividend means dividend approved to be paid. It is paid within 30 days of declaration and therefore will result in Outflow of Cash.
45. (2) **Explanation:** Dividend is paid/received on the nominal (face) value of the shares. Hence, dividend received will be ₹ 20,000 (20% of ₹ 1,00,000). Since purchase of shares is an investment, dividend received will be shown as inflow under Investing Activities.
46. (2) **Explanation:** Patents is an intangible asset. Thus, payment for purchase of patent will be shown as Outflow of Cash and Cash Equivalent under Investing Activity.
47. (1) **Explanation:** Receipts from Commission and Royalties are shown as Operating Activities because it is the principal revenue producing activity of the business.
48. (1) **Explanation:** Interest received and paid is an Operating Activity for a finance company because lending and borrowing is its principal revenue producing activity.
49. (2) **Explanation:** The company is a non-finance company since the status of the company is not given. Loans and advances given by a non-finance company is Investing Activity.
50. (4) **Explanation:** Issue of Bonus Shares does not involve inflow of cash, it being capitalisation of reserves. Hence, it is not shown in Cash Flow Statement.
51. (1) **Explanation:** A mutual fund company is a financial enterprise thus, dividend received of ₹ 8,00,000 received by the company from its investments in shares of other company is cash inflow from its Operating Activities.

52. (4) **Explanation:**

<b>Cash Flow from Financing Activities:</b>	₹
Proceeds from Issue of Equity Shares	12,00,000
Premium on Shares	1,20,000
Proceeds from Issue of Preference Shares	6,00,000
Share Issue Expenses	(45,000)
Cash Flow from Financing Activities	<u>18,75,000</u>

53. (3) **Explanation:**

<b>Cash Flow from Financing Activities:</b>	₹
Proceeds from Issue of Equity Shares (20,000 × ₹ 100)	20,00,000
Premium on shares (20,000 × ₹ 10)	2,00,000
Proceeds from Issue of 9% Debentures (10,000 × ₹ 95)	9,50,000
Underwriting Commission	(20,000)
Interest on Debentures (9% of ₹ 10,00,000)	(90,000)
Cash Flow from Financing Activities	<u>30,40,000</u>

54. (1) **Explanation:**

<b>Cash Flow from Investing Activities:</b>	₹
Payment for purchase of Machine (₹ 12,50,000 + ₹ 50,000)	(13,00,000)
Cash Used in Investing Activities	<u>(13,00,000)</u>
<b>Cash Flow from Financing Activities:</b>	₹
Proceeds from Issue of Equity Shares (40,000 × ₹ 100)	40,00,000
Premium on Shares (40,000 × ₹ 10)	4,00,000
Proceeds from Issue of 9% Debentures (20,000 × ₹ 95)	19,00,000
Underwriting Commission	(30,000)
Interest on Debentures (9% of ₹ 20,00,000 for 8 months)	(1,20,000)
Cash Flow from Financing Activities	<u>61,50,000</u>

55. (2) **Explanation:**

<b>Cash Flow from Operating Activities:</b>	₹
Cash Flow from Operating Activities (A) (₹ 4,20,000 + ₹ 90,000 Interest on Debentures)	5,10,000
<b>Cash Flow from Investing Activities:</b>	₹
Payment for purchase of Machine (₹ 7,50,000 + ₹ 40,000)	(7,90,000)
Proceeds from Sale of old Machine	<u>60,000</u>
Cash Used in Investing Activities (B)	<u>(7,30,000)</u>
<b>Cash Flow from Financing Activities:</b>	₹
Proceeds from Issue of Preference Shares (10,000 × ₹ 110)	11,00,000
Proceeds from Issue of 9% Debentures (12,000 × ₹ 95)	11,40,000
Interest on Debentures (9% of ₹ 12,00,000 for 10 months)	(90,000)
Cash Flow from Financing Activities (C)	<u>21,50,000</u>
Net Increase/Decrease in Cash and Cash Equivalents (A + B + C)	19,30,000

56. (1) **Explanation:** Payment of Income Tax is shown as Operating Activity unless the income tax paid is related to Investing or Financing Activities.

57. (1) **Explanation:** Interest is paid on borrowings and hence, it is shown under Financing Activity.

58. (2) **Explanation:** Since Debentures purchased have maturity period of 100 days, i.e., beyond the period of 3 months prescribed in AS 3, Cash Flow Statement, it is not included in Cash and Cash Equivalents.

59. (3) **Explanation:** Interest on debentures paid are added to Net Profit before Tax and Extraordinary Items as Non-operating expenses but not as Non-cash Expense.

60. (2) **Explanation:**

**Cash Flow from Investing Activities:**

Sale Proceeds of Machinery	₹ 25,000
Purchase of Machinery*	(1,50,000)
Cash Used in Investing Activities	<u>(1,25,000)</u>

\*Purchase of Machinery = ₹ 9,50,000 (Closing Machinery) + ₹ 20,000 (Value of Sold Machinery) + ₹ 40,000 (Depreciation) – ₹ 8,60,000 (Opening Machinery) = ₹ 1,50,000.

61. (3) **Explanation:**

Tax Paid = ₹ 50,000 (Opening Balance) + ₹ 65,000 (Provision Made) – ₹ 75,000 (Closing Balance) = ₹ 40,000.

62. (1) **Explanation:** Previous Year's proposed dividend is declared by the shareholders in the current year. It being a financing activity is added to net profit before Tax Extraordinary Items. It is shown as outflow under Financing Activities.

63. (4) **Explanation:** Cash Flow Statement is prepared showing cash inflow and outflow. In the current question, cash outflow is ₹ 8,00,000 (40% of ₹ 20,00,000).

64. (2) **Explanation:** Cash Flow Statement shows cash inflows and outflows. In the present question, Purchase Consideration to the extent of ₹ 7,50,000 is paid by consideration other than cash and balance ₹ 2,50,000 by cheque. Thus, outflow of cash under Investing Activity is ₹ 2,50,000.

65. (2) **Explanation:** The Principal Revenue Producing Activity of the stock broker is earning commission for purchase and sale of securities for his clients. Purchases of Shares in a Limited company by a stock broker is not his principal revenue producing activity but is Investing Activity.

66. (3) **Explanation:** IDFC Bank Ltd. has issued debentures for financing its business. Hence, it is Financing Activity. Issue of Debentures is different from regular borrowing and lending, which is its principal revenue producing activity.

67. (3) **Explanation:**

**Cash Flow from Financing Activities:**

Redemption of 12% Debentures	₹ (40,000)
Payment of Interest on Debentures*	(21,600)
Cash Used in Financing Activities	<u>(61,600)</u>

\*(₹ 2,00,000 × 12/100 × 6/12) + (₹ 1,60,000 × 12/100 × 6/12) = ₹ 12,000 + ₹ 9,600 = ₹ 21,600.

## 2. CASE STUDY BASED MCQS

1. A. 4. **Explanation:**

PROVISION FOR TAX ACCOUNT			
Dr.		Cr.	
Particulars	₹	Particulars	₹
To Bank A/c (Tax Paid)	37,000	By Balance b/d	70,000
To Balance c/d	50,000	By Statement of Profit & Loss (Tax provided) (Balancing Figure)	17,000
	<u>87,000</u>		<u>87,000</u>

B. 1. **Explanation:**

NET PROFIT BEFORE TAX AND EXTRAORDINARY ITEMS

Particulars	₹
<b>Cash Flow from Operating Activities</b>	
<i>Net Profit Before Tax and Extraordinary Items:</i>	
Net Profit for the year as per difference between the Closing and Opening Balance of Surplus, i.e., Balance in Statement of Profit & Loss	1,00,000
Add: Provision for Tax made during current year	17,000
<b>Net Profit Before Tax and Extraordinary Items</b>	<u>1,17,000</u>

C. 3. Explanation:

OPERATING PROFIT BEFORE WORKING CAPITAL CHANGES

Particulars	₹	₹
Net Profit before Tax and Extraordinary Items		1,17,000
<i>Add: Non-cash/Non-operating Items:</i>		
Depreciation on Plant and Machinery	1,55,000	
Loss on Sale of Machinery	28,000	
Interest on Debentures (11% of ₹ 6,00,000)	66,000	2,49,000
<b>Operating Profit before Working Capital Changes</b>		<b>3,66,000</b>

D. 1. Explanation:

CASH GENERATED FROM OPERATIONS

Particulars	₹	₹
Operating Profit before Working Capital Changes		3,66,000
<i>Less: Decrease in Current Liabilities and Increase in Current Assets:</i>		
Trade Payables	68,000	
Trade Receivables	1,32,000	
Inventories	1,05,000	3,05,000
<b>Cash Generated from Operations</b>		<b>61,000</b>

E. 2. Explanation:

CASH FLOW FROM OPERATING ACTIVITIES

Particulars	₹
Cash Generated from Operations	61,000
<i>Less: Tax Paid</i>	37,000
<b>Cash Flow from Operating Activities</b>	<b>24,000</b>

F. 3. Explanation:

Dr.		PLANT AND MACHINERY ACCOUNT		Cr.	
Particulars	₹	Particulars	₹		
To Balance <i>b/d</i>	5,00,000	By Bank A/c (Sale)	1,58,000		
To Bank A/c—Purchase (Balancing Figure)	6,41,000	By Loss on Sale of Machinery A/c (Statement of Profit & Loss)	28,000		
		By Depreciation A/c	1,55,000		
		By Balance <i>c/d</i>	8,00,000		
	<b>11,41,000</b>		<b>11,41,000</b>		

G. 1. Explanation:

CASH FLOW FROM INVESTING ACTIVITIES

Particulars	₹
<b>Cash Flow from Investing Activities</b>	
Purchase of Plant and Machinery	(6,41,000)
Sale of Plant and Machinery	1,58,000
<b>Cash Used in Investing Activities</b>	<b>(4,83,000)</b>

H. 3. Explanation:

CASH FLOW FROM FINANCING ACTIVITIES

Particulars	₹
<b>Cash Flow from Financing Activities</b>	
Receipts from Issue of Equity Shares	3,00,000
Receipts from Issue of 11% Debentures	1,50,000
Interest on Debentures	(66,000)
<b>Cash Flow from Financing Activities</b>	<b>3,84,000</b>

2. A. 2. Explanation:

CASH FLOW FROM OPERATING ACTIVITIES

Particulars	₹
<b>Net Profit Before Tax and Extraordinary Items</b>	
Net Profit for the year as per difference between the Closing and Opening balance of Surplus, i.e., Balance in Statement of Profit & Loss	70,000
Add: Provision for Tax	90,000
	1,60,000
Less: Tax Refund	20,000
<b>Net Profit Before Tax and Extraordinary Items</b>	<b>1,40,000</b>

B. 4. Explanation:

OPERATING PROFIT BEFORE WORKING CAPITAL CHANGES

Particulars	₹
<b>Net Profit before Tax and Extraordinary Items</b>	1,40,000
Add: Non-cash and Non-operating Expenses:	
Depreciation on Machinery	10,000
Loss on Sale of Machinery	5,000
	15,000
Less: Non-operating Incomes:	
Gain on Sale of Investments	20,000
<b>Operating Profit before Working Capital Changes</b>	<b>1,35,000</b>

C. 4. Explanation:

NET EFFECT OF CHANGES IN WORKING CAPITAL

Particulars	₹
<i>Adjustment for Change in Current Assets and Current Liabilities:</i>	
Decrease in Trade Receivables	10,000
Decrease in Outstanding Expenses	(5,000)
Increase in Inventories	(5,000)
	Nil

D. 3. Explanation:

PROVISION FOR TAX ACCOUNT

Dr.		Cr.	
Particulars	₹	Particulars	₹
To Bank A/c (Tax paid)	60,000	By Balance b/d	50,000
To Balance c/d	80,000	By Statement of Profit & Loss (Tax provided) (Balancing Figure)	90,000
	1,40,000		1,40,000

E. 3. Explanation:

CASH FLOW FROM OPERATING ACTIVITIES

Particulars	₹
<b>Operating Profit before Working Capital Changes</b>	1,35,000
Net Effect of Changes in Working Capital	Nil
<b>Cash Generated from Operations</b>	1,35,000
Less: Tax Paid (Net of Refund) ₹(60,000 – 20,000)	40,000
<b>Cash Flow from Operating Activities</b>	<b>95,000</b>

3. A. 4. Explanation:

PROVISION FOR TAX ACCOUNT

Dr.		Cr.	
Particulars	₹	Particulars	₹
To Bank A/c (Tax Paid)	1,00,000	By Balance b/d	1,40,000
To Balance c/d	1,50,000	By Statement of Profit & Loss (Balancing Figure)	1,10,000
	2,50,000		2,50,000

**B. 3. Explanation:**

## NET PROFIT BEFORE TAX AND EXTRAORDINARY ITEMS

Particulars	₹
Net Profit as per the difference between Closing and Opening Balance of Surplus, <i>i.e.</i> , Balance in Statement of Profit & Loss	1,00,000
Add: Transfer to General Reserve	1,00,000
Provision for Tax	1,10,000
<b>Net Profit before Tax and Extraordinary Items</b>	<b>3,10,000</b>

**C. 2. Explanation:**

## OPERATING PROFIT BEFORE WORKING CAPITAL CHANGES

Particulars	₹	₹
<b>Cash Flow from Operating Activities</b>		
Net Profit before Tax and Extraordinary Items		3,10,000
Add: <i>Non-cash and Non-operating Expenses:</i>		
Depreciation on Plant and Machinery	50,000	
Goodwill Amortised	1,00,000	1,50,000
		4,60,000
Less: <i>Non-operating Income:</i> Interest on Investments		20,000
<b>Operating Profit before Working Capital Changes</b>		<b>4,40,000</b>

**Note:** In the absence of information about purchase of further Investment, it has been presumed that it has been purchased at the end of the current period. Thus, Interest on Investments has been calculated on the opening Balance of Investment. Interest on Investment = ₹ 2,00,000 × 10/100 = ₹ 20,000.

**D. 3. Explanation:**

## NET EFFECT OF CHANGES IN WORKING CAPITAL

Particulars	₹	₹
<b>Net Effect of Changes in Working Capital</b>		
Adjustment for Change in Current Assets and Current Liabilities:		
Decrease in Trade Receivables	30,000	
Decrease in Trade Payables	(10,000)	
Increase in Inventories	(1,00,000)	(80,000)

**E. 4. Explanation:**

## CASH FLOW FROM OPERATING ACTIVITIES

Particulars	₹
<b>Operating Profit before Working Capital Changes</b>	4,40,000
Net Effect of Changes in Working Capital	(80,000)
Cash Generated from Operations	3,60,000
Less: Tax Paid	1,00,000
<b>Cash Flow from Operating Activities</b>	<b>2,60,000</b>

**F. 1. Explanation:**

## CASH FLOW FROM INVESTING ACTIVITIES

Particulars	₹
Interest on 10% Investments	20,000
Purchase of Plant and Machinery	(2,50,000)
Purchase of 10% Investments	(3,00,000)
<b>Cash Used in Investing Activities</b>	<b>(5,30,000)</b>

**Note:** In the absence of information about purchase of further Investment, it has been presumed that it has been purchased at the end of the current period. Thus, Interest on Investments has been calculated on the opening Balance of Investment.

Interest on Investment = ₹ 2,00,000 × 10/100 = ₹ 20,000.

G. 3. **Explanation:**

CASH FLOW FROM FINANCING ACTIVITIES

Particulars	₹
Proceeds from Issue of Shares	2,00,000
Receipts of Securities Premium Reserve	1,00,000
<b>Cash Flow from Financing Activities</b>	<b>3,00,000</b>

**3. SEQUENCE BASED MCQS**

1. 3. **Explanation:**

- D. Net Profit as per Surplus, *i.e.*, Balance in Statement of Profit & Loss
- B. Net Profit before Tax and Extraordinary Items
- A. Operating Profit before Working Capital Changes
- C. Cash Generated from Operations
- E. Cash Flow from Operating Activities

The first step is to determine Net Profit before Tax and Extraordinary Items. It starts with difference between Closing balance and Opening Balance of Surplus, *i.e.*, balance in Statement of Profit & Loss. Adjustments are made for non-cash non-operating items that have affected profit or loss for the year.

Next step is to make changes due to Working Capital Changes and determine Cash Generated from Operations and amount of Cash Flow from Operating Activities is determined.

2. 1. **Explanation:**

- A. Add appropriations towards Reserves, Dividend and Tax, they being appropriations of profit.
- C. Adjustment for Non-operating and Non-cash Items. Non-operating entries (items) are adjusted to be shown under relevant head of Cash Flow.
- D. Adjustment for Change in Working Capital, *i.e.*, Current Assets and Current Liabilities.
- B. Deduct Tax Paid (Net of Refund).

**4. MATCHING QUESTIONS**

1. 3. **Explanation:**

- A. Financial company is involved in activity (III), purchase and sale of securities.
- B. Trading company is involved in activity (IV), purchase and sale of goods.
- C. Insurance company is associated with (II), receipt of premiums and payments of claims.
- D. Manufacturing company is involved in activity (I), manufacturing and selling of products.

2. 4. **Explanation:**

- A. Preliminary Expenses is classified as (II), Operating Activity.
- B. Receipt of Dividend is on investment hence, is (III), Investing Activity.
- C. Buy-back of Own Shares is (IV), Financing Activity being reduction in Share Capital through payment.
- D. Sale of Marketable Investment does not involve (I), No Flow of Cash.

3. 1. **Explanation:**

A. Operating Profit before Working Capital Changes	(IV) Adjustment for change in Current Assets and Current Liabilities
B. Net Profit before Tax and Extra-ordinary Items	(III) Adjustment for Non-ordinary Items
C. Net Profit as per difference of Closing and Opening Surplus	(I) Add Appropriations towards Reserves, Dividend and Tax
D. Cash Generated from Operations	(II) Less Tax Paid (Net of Refund)

4. 4.

5. 2.

6. 2.

7. 3.

8. 2.

## 5. COMBINATION WITH SINGLE ANSWER QUESTIONS

1. 3. **Explanation:** Proceeds from sale of fixed assets, cash receipt of brokerage and increase in bank overdraft are sources of cash. Underwriting commission paid and increase in goodwill are application (outflow) of cash.
2. 2. **Explanation:** None of the transactions are sources or application of cash.
3. 2. **Explanation:** Limitations of Cash Flow Statement are:
  - B. It shows only inflow and outflow of cash as non-cash items, howsoever important they may be, are shown in Cash Flow Statement.
  - C. It does not determine profit earned or loss incurred during a year. Thus, it is not a substitute of Statement of Profit & Loss.
  - E. It is historical in nature, being based on historical records.
4. 3. **Explanation:** Loss on Issue of Debentures and Loss on Sale of Fixed Assets being non-operating expenses are added to Net Profit before Tax and Extraordinary Items while Dividend Received being non-operating income is deducted from Net Profit before Tax and Extraordinary Items while computing Operating Profit before Working Capital Changes.
5. 4. **Explanation:** Cost of Materials Consumed, Changes in Inventories of Finished Goods, Work-in-Progress and Stock-in-Trade, Employees Benefit Expenses and Depreciation and Amortization Expenses are always shown or classified or shown as Operating Activities for a manufacturing company as they are associated with the operations of the company to earn profit. They are neither Investing nor Financing Activities.
6. 2. **Explanation:** All other items except goodwill amortised are added to Profit (*i.e.*, difference between Closing and Opening balance of Surplus, *i.e.*, Balance in Statement of Profit & Loss) while computing Net Profit before Tax and Extraordinary Items. Goodwill amortised is a non-cash expense.
7. 3. **Explanation:** Refund of Tax (shown as inflow towards the end of Cash Flow from Operating Activities), Insurance Claim Received (shown as inflow under Cash Flow from Investing Activities) and Gain on Sale of Marketable Securities (it is included in Cash and Cash Equivalents) are deducted from Profit (*i.e.*, difference between Closing and Opening balances of Surplus, *i.e.*, Balance in Statement of Profit & Loss) while computing Net Profit before Tax and Extraordinary Items.
8. 2. **Explanation:** All the items except preliminary expense are added to Profit (*i.e.*, difference between Closing and Opening balances of Surplus, *i.e.*, Balance in Statement of Profit & Loss) while computing Net Profit before Tax and Extraordinary Items. Since it has been written off from Securities Premium, it is not added to determine Net profit. Preliminary expense is added, if it is written off from Statement of Profit & Loss and towards the end it is deducted to compute Cash Flow from Operating Activities before Extraordinary Items.
9. 2. **Explanation:** Refund of Tax and Insurance Claim received are deducted from Profit (*i.e.*, difference between Closing and Opening balances of Surplus, *i.e.*, Balance in Statement of Profit & Loss) while computing Net Profit before Tax and Extraordinary Items. Rent received, Provision for Doubtful Debts Written Back and Dividend received are deducted from Net Profit before Tax and Extraordinary Items while computing Operating Profit before Working Capital Changes but they are not deducted to arrive at Net Profit before Tax and Extraordinary Items.
10. 4. **Explanation:** Purchase of Plant and Equipment on deferred payment basis and purchase of machinery for consideration other than cash are not shown or classified as Investing Activities as there either payment is to be made later or is not made in cash.

11. 2. **Explanation:** All transactions except decrease in amount of goodwill are classified as Investing Activity as the amount of goodwill is written off which is added to Net Profit Before Tax and Extraordinary Items under Cash Flow from Operating Activities.
12. 2. **Explanation:** Issue of Bonus Shares and Issue of Shares against purchase of Machinery are not shown under Financing Activity as they do not involve cash inflow. Remaining entries (items) are shown as Financing Activities because inflow of cash is involved and they are transactions which change the composition and size of capital and borrowings.
13. 4. **Explanation:** Conversion of Debentures into Shares and Receipt of Dividend are not shown as Financing Activities as conversion of debentures does not result in flow of cash while Receipt of Dividend is shown as inflow under Cash Flow from Investing Activities.
14. 2. **Explanation:** All items except Loss on Issue of Debentures are not added to Net Profit before Tax and Extraordinary Items while computing Operating Profit before Working Capital Changes.
15. 2. **Explanation:** All items except Gain (Profit) on Sale of Machinery are not deducted from Net Profit before Tax and Extraordinary Items while computing Operating Profit before Working Capital Changes.
16. 4. **Explanation:** While computing Cash Flow from Operating Activities, Increase in Accrued Interest on Non-current Investments, Preliminary Expenses and Gain (Profit) on Sale of Fixed Asset are not added, if starting point is Surplus, *i.e.*, Balance in Statement of Profit & Loss.
17. 2. **Explanation:** While computing Cash Flow from Operating Activities, Transfer to Provision for Doubtful Debts, Sale Proceeds of Machinery and Increase in Accrued interest on Non-current Investment are not deducted, if starting point is Surplus, *i.e.*, Balance in Statement of Profit & Loss.