

## CHAPTER 4

**Answers to every alternate question have been provided. This gives you an opportunity to work on the rest problems & come up with relevant solutions. You are requested to complete this chapter before attempting the questions.**

### Exercise

1. 1 (a) New issue of share capital  
(b) New issue of bonds  
(c.) Sale proceeds of Fixed Assets

- 1.2 (a) .....  
(b) .....  
(c.) .....

- 1.3 (a) Account Payable  
(b) Short term loans  
(c.) Tax provisions

- 1.4 (a) .....  
(b) .....  
( c) .....

2. Indicate the following transactions in a Funds Flow Statement:

- A. Amount transferred to provision for taxation – (a)
- B. ....
- C. Conversion of debentures into preference shares – (c)
- D. ....
- E. Income tax refund – (a)
- F. ....
- G. Issue of shares in exchange of fixed assets – (c)
- H. ....
- I. Provision created for depreciation – (a)
- J. ....
- K. Repayment of loan – (b)
- L. ....
- M. Issue of Employee Stock option – (c )
- N. ....
- O. Converting ESOP to Equity Shares – (a)
- P. ....
- Q. Provision for warranties – (a)
- R. ....
- S. Redemption of Preference Shares – (b)
- T. ....
- U. Sale of land – (a)
- V. ....

- W. Purchase of competitors shares – (b)
- X. ....
- Y. Loss of inventory (due to theft) – (b)
- Z. ....

3. Indicate the following transactions in a Funds Flow Statement:

	<i>Assets (Change)</i>	<i>Liabilities (Change)</i>
<i>Sources of Funds</i>	–	+
<i>Use of Funds</i>	+	–

Once a particular blank has been filled – the rest will get filled automatically. This matrix can also be remembered as USA Limited.

4. Fill in the Blanks (for Financial Years 2006-07):

<b>Company Name ↓</b>	<b>Activity →</b>	Operating Activities	Financing Activities	Investment Activities
Asian Paints Limited		Cash Inflow	Cash Outflow	Largely Cash Outflow and a few times Cash Inflow
Balarampur Chini Ltd.		Cash Outflow <sup>1</sup>	Cash Inflow	Can't Say
Bharti Airtel Limited		?	?	?
Dainik Jagaran Ltd.		Can't Say	Cash Inflow	Cash Outflow
Deccan Airways		?	?	?
Hero Honda		Cash Inflow	Cash Outflow	Cash Outflow
National Fertilizers Limited		?	?	?
ONGC Limited		Cash Inflow	Cash Outflow	Cash Outflow
Punj Lloyds Ltd.		?	?	?
Suzlon Ltd.		Cash Inflow	Cash Inflow	Cash Outflow

Economic times do change and it is always a dynamic world. Hence, we suggest you to modify your views based on the existing economic and industry context [at the time of reading this book and solving this problem].

<sup>1</sup> Sugar in 2007 is having a tough time.

5. A. (b) Investing Activities
- B. ....
- C. (a) Operating Activities
- D. ....
- E. (a) Operating Activities, Net Cash Inflow of s 100 crore

**CHAPTER 4**  
**Review Questions**

**1 Ani Initiatives**

- (a) Please refer the excel sheet FAM.2e\_Chap4\_Exercises\_Solution.RR
- (b) In case of depreciation, the treatment is different. In the P&L a/c, we have deducted the depreciation amount from Gross Profit for deriving the Operating Profit. As depreciation is a non cash flow entity, we add it back to Net Profit for determining cash flow.
- (c) The cash flow through Indirect Method at the end of each month is coming same as the cash flow determined by the Direct Method. Please refer the same excel sheet.
- (d) Madam Ani is not facing any cash constraints as in all the months she is having positive cash balances. Please refer the same excel sheet.

### 3 Kaushalya Paper Products Limited:

Kaushalya Paper Products Limited  
 Statement of Sources and Application of Funds<sup>2</sup>

<u>Sources:</u>		
Funds from Operation *		60,000
Sale of Buildings		1,10,000
Sale of Long Term Investment		20,000
	(A)	1,90,000
<u>Application:</u>		
Repayment of Long Term Loan		20,000
Purchase of Land		20,000
Purchase of Machinery		90,000
	(B)	1,30,000
Increase in Working Capital**		60,000

\* Funds from operation is the difference in the profit and loss accounts balance (due to lack of information, we ignore adjustments due to non-cash expenses such as depreciation or amortization)

\*\* The change in working capital can also be calculated by way of the statement of changes in working capital in the following way:

Kaushalya Paper Products Limited  
 Statement of Changes in Working Capital<sup>3</sup>

Particulars	20X4	20X5	Change in Working Capital
<u>Current Assets:</u>			
Stock	80,000	1,00,000	20,000
Debtors	40,000	60,000	20,000
Cash	10,000	20,000	10,000
	(A)	1,80,000	50,000
<u>Current Liabilities:</u>			
Bills Payable	50,000	20,000	30,000
Sundry Creditors	50,000	70,000	(20,000)
	(B)	90,000	10,000
Working Capital (A) – (B)	30,000	90,000	
Increase in Working Capital			60,000

<sup>2</sup> We can use matrix given in problem 2 (of Chapter 4 Exercise i.e., USA Limited) after identifying the changes in all non-current assets and liabilities.

<sup>3</sup> We can use matrix given in problem 2 (of Chapter 4 Exercise) after identifying the changes in all working capital related items i.e., current assets and liabilities.

Comment:

The company’s operations seem to be quite profitable and generating enough cash. In the last one year, the company seems to have invested all the funds generated from operations into increasing its working capital. The company also seems to have funded its investment in long-term assets (such as land and plant & machinery) by disposing its other non-current assets (such as building and investments) possibly having limited utility.

## 5 Basant Exports Limited:

Looking at the problem, we can make out that the Balance Sheet needs to be redrafted to calculate the missing figures in the following way.

ASSETS	20X4	20X5	LIABILITIES	20X4	20X5
Bank Balance	2,00,000	–	Bank Overdraft	-	80,000
Bills Receivable	50,000	75,000	Sundry Creditors	1,50,000	2,00,000
Inventory	1,50,000	2,00,000	Share Capital	2,00,000	3,00,000
Sundry Debtors	4,50,000	4,00,000	Other Liabilities <sup>4</sup> (* will be used as a balancing figure)	9,00,000	5,95,000
Fixed Assets	4,00,000	5,00,000			
	12,50,000	11,75,000		12,50,000	11,75,000

Given limited information availability, we will proceed to prepare the *Statement of Cash Flow*:

### Basant Exports Limited Statement of Cash Flow 20X5 (all figures in Rs)

<b>Cash Flow from Operating Activities</b>		
Increase in Bills Receivable	(25,000)	
Decrease in Sundry Debtors	50,000	
Increase in Inventory	(50,000)	
Increase in Sundry Creditors	50,000	
<b>Net cash flow from Operating Activities</b>		<b>25,000</b>
<b>Cash Flow from Investing Activities</b>		
Investment in Fixed Assets	(1,00,000)	
<b>Net cash flow from Investing Activities</b>		<b>(1,00,000)</b>
<b>Cash Flow from Financing Activities</b>		
Repayment of Other Liabilities	(3,05,000)	
Issue of Share Capital	1,00,000	
<b>Net cash flow from Financing Activities</b>		<b>(2,05,000)</b>
<b>Net Increase/Decrease in Cash</b>		<b>(2,80,000)</b>
<b>Cash at the Start of the Period</b>		<b>2,00,000</b>
<b>Cash at the End of the Period</b>		<b>(80,000)</b>

Comment:

Given limited information and assumption one can state that the large amount of repayment in other liabilities and investment in fixed assets resulted in using of over draft. Though the firm did mitigate the problem by its share capital it also needs to find new (and larger) sources of long-funds to come out this problem.

<sup>4</sup> Considering the CEO Mr Basant Purohit’s confident statement, we presume that the firm was doing well and hence we did not consider ‘retained earnings’ as the balancing figure.

## 7. Pragati Exports

### A. Estimating Cash Flow from Operations

<b>Net Profit</b>	<b>500000</b>	Comments
Profits from sale of land	(15000)	Non operational activity
Income from Dividends & Interests	(10000)	Non operational activity
Depreciation	5000	Non cash outflow activity
Net Profit from Operations	<b>480000</b>	
A/c receivable	(100000)	increased
A/c payable	(100000)	decreased
Inventory	10000	decreased
Prepaid rent	3000	decreased
Unearned Service Revenue	50000	increased
Salaries Payable	7000	increased
<b>Cash from Operations</b>	<b>350000</b>	

### B. Estimating Cash Flow from Investing

Purchase of investment securities	(500000)
Profit from Sale of Land	15000
Interest & Dividend income from investments	10000
<b>Cash from Investing</b>	<b>(475000)</b>

### C. Estimating Cash Flow from financing

Issue of Common Stock	100000
Retirement of Loan	(50000)
Payment of cash dividends	(15000)
<b>Cash from financing</b>	<b>35000</b>

So, the net cash flow = A + B+ C = (90000).

It is clear that there is a cash crunch of Rs 90000.

So, Pragati Export needs to look into their Cash Management with extra care.