

1     **Answer:** B) To analyze changes in financial position due to cash inflows and outflows

**Explanation:**

A Cash Flow Statement (CFS) helps in understanding how cash is generated and utilized. Unlike the Profit & Loss Account, which measures profitability, the CFS focuses on actual cash movements, helping stakeholders assess the company's liquidity and financial health. It categorizes cash flows into **Operating Activities, Investing Activities, and Financing Activities**, making it a crucial financial statement for decision-making.

2     **Answer:** B) AS 3

**Explanation:**

In India, the preparation of a Cash Flow Statement follows **Accounting Standard (AS) 3**, issued by the **Institute of Chartered Accountants of India (ICAI)**. This standard mandates companies to classify cash flows into three categories:

- **Operating Activities:** Cash flows from core business operations.
- **Investing Activities:** Cash flows related to the purchase or sale of assets.
- **Financing Activities:** Cash flows from issuing or repaying debt and equity.

AS 3 ensures consistency and comparability in financial reporting.

3.     **Answer:** C) Receipt from sale of goods

**Explanation:**

**Operating activities** include cash flows related to a company's primary revenue-generating activities, such as cash receipts from customers, payments to suppliers, and employee salaries. The sale of goods is part of daily business operations, making it an operating activity. Other options, such as purchasing land (investing), paying dividends (financing), and issuing debentures (financing), do not fall under operating activities.

4.     **Answer:** B) The way operating cash flows are calculated

**Explanation:**

There are two methods of preparing the **Operating Activities** section of a Cash Flow Statement:

- **Direct Method:** Lists all cash receipts and payments directly.
- **Indirect Method:** Starts with net profit and adjusts for non-cash items (e.g., depreciation, changes in working capital).

The indirect method is more commonly used since it derives cash flows from the accrual-based income statement.

5. **Answer:** B) It does not involve actual cash outflow

**Explanation:**

Depreciation is a **non-cash expense**, meaning no actual cash is spent when recording it. Since the indirect method starts with net profit (which includes depreciation as an expense), depreciation is added back to adjust the net income to reflect only actual cash movements.

6 **Answer:** A) Sale of machinery

**Explanation:**

**Investing activities** involve transactions related to long-term assets and investments. The sale of machinery is classified under investing activities since it involves the disposal of a fixed asset. Other options (rent, interest, and share issuance) belong to different categories.

7 **Answer:** C) Financing Activities

**Explanation:**

Cash received from the **issuance of shares** is classified under **financing activities** as it relates to raising capital from shareholders. Financing activities cover transactions that change the company's capital structure, such as issuing or repurchasing shares and borrowing or repaying loans.

8 **Answer:** B) Investing Activities

**Explanation:**

The **purchase of a building** is an investment in a long-term asset, making it an **investing activity**. Investing activities include buying/selling property, plants, and equipment, as well as acquiring or disposing of investments.

9 **Answer:** C) It is recorded under financing activities

**Explanation:**

Dividend payments represent a **return to shareholders** and fall under **financing activities**. Financing activities involve transactions related to equity and debt, such as issuing shares, borrowing, repaying loans, and paying dividends.

10 **Answer:** C) Sale of investment

**Explanation:**

The **sale of an investment** generates cash inflow and is classified under **investing activities**. The other options involve cash outflows: repaying a loan (financing activity), purchasing equipment (investing activity), and paying salaries (operating activity).

11 **Answer:** D) Accounts receivable

 **Explanation:** Cash equivalents are **highly liquid short-term investments** that can be readily converted into cash with minimal risk. **Treasury bills, marketable securities, and bank overdrafts (if repayable on demand)** qualify as cash equivalents. However, **accounts receivable represent credit sales** and do not guarantee immediate cash inflow. Therefore, they are not included under cash and cash equivalents.

12  **Answer:** A) Direct Method

 **Explanation:** Accounting Standard (Ind AS 7) recommends using the Direct Method for preparing the Cash Flow Statement, as it provides more transparency by listing specific cash receipts and payments. However, in practice, many companies use the Indirect Method, which adjusts net profit for non-cash items and changes in working capital to determine cash flows from operating activities.

13  **Answer:** B) It reduces net profit but does not involve cash outflow

 **Explanation:** Depreciation is a **non-cash expense** recorded in the **income statement** to allocate the cost of an asset over its useful life. Since it does not affect actual cash flows, it is added back to net profit when preparing cash flows using the **Indirect Method** to reflect accurate cash movements.

14  **Answer:** B) Investing Activities

 **Explanation:** Investing activities include cash flows related to **acquisition and disposal of long-term assets** such as land, buildings, and equipment. The **purchase**

**of new machinery represents an investment in fixed assets**, making it a part of investing activities.

15  **Answer:** D) Sale of fixed assets

 **Explanation:** **Financing activities** include cash flows related to borrowing, repaying debts, and issuing equity or dividends. The **sale of fixed assets** falls under **Investing Activities**, as it involves the disposal of long-term assets rather than financial transactions.

16 **Answer:** A) Summing the balances from all three activities

 **Explanation:** The total cash flow is determined by summing the net cash flows from **Operating, Investing, and Financing Activities**. This final figure is reconciled with the opening and closing cash and cash equivalents balances to confirm the net increase or decrease.

17  **Answer:** B) Dividends paid

 **Explanation:** **Financing activities** involve transactions that affect the company's capital structure. **Dividend payments to shareholders** are classified under financing activities, as they represent cash outflows related to the distribution of profits.

18 **Answer:** D) Companies can classify them under Operating or Financing Activities based on their nature

 **Explanation:** **As per Ind AS 7**, interest and dividends can be classified under either **Operating or Financing Activities**, depending on the entity's policies. If interest relates to working capital, it is an **Operating Activity**. If it relates to long-term debt, it is a **Financing Activity**. Similarly, dividends paid are typically **Financing Activities**, while dividends received may be treated as **Investing Activities**.

19  **Answer:** B) Listing cash receipts and payments directly

 **Explanation:** The **Direct Method** presents actual cash receipts and payments instead of adjusting net income for non-cash expenses. It includes categories such as **cash collected from customers, cash paid to suppliers, and cash paid for operating expenses**, providing a more transparent representation of cash movements.

20  **Answer:** C) Purchasing inventory for cash

 **Explanation:** When a company **purchases inventory for cash**, it results in an **outflow of cash** under **Operating Activities**. While issuing shares, taking a loan, or selling assets increase cash inflow, inventory purchases reduce cash availability.

21  **Answer:** B) Issuance of debentures

 **Explanation:** **Financing activities** include cash flows related to capital structure, such as **raising or repaying long-term funds**. Issuing **debentures** is a method of raising finance, making it a **cash inflow under financing activities**. In contrast, **purchase of land** falls under investing activities, **payment for inventory** is an operating activity, and **depreciation** is a non-cash expense, meaning it does not appear in the cash flow statement directly.

22  **Answer:** D) Not reflected in the Cash Flow Statement

 **Explanation:** A **bonus share issue** involves converting **retained earnings or reserves** into share capital, meaning **no actual cash flow occurs**. Since a Cash Flow Statement records only **cash and cash-equivalent transactions**, issuing bonus shares does not appear in it. This makes it different from issuing shares for cash, which is a **financing activity**.

23  **Answer:** D) Proceeds from issuing shares

 **Explanation:** **Investing activities** involve transactions related to the acquisition and disposal of long-term assets and investments. The **issuance of shares** is related to raising capital, which falls under **financing activities**. Conversely, **buying fixed assets**, **selling marketable securities**, and **receiving dividends** are classified as investing activities.

24  **Answer:** C) Financing Activity

 **Explanation:** **Financing activities** deal with transactions affecting a company's **capital structure**. **Loan repayment** reduces liabilities and is considered a **cash outflow under financing activities**. The interest paid on the loan, however, is usually treated as an **operating activity**.

25  **Answer:** D) Cash and Cash Equivalents

 **Explanation: Bank overdrafts**, when repayable on demand, are included in **cash and cash equivalents** since they represent short-term borrowing. This classification helps businesses reflect their **actual cash position** at the end of the financial period.

26  **Answer:** B) Purchase of machinery

 **Explanation: Purchase of machinery** is classified under **investing activities** because it involves acquiring a long-term asset. It results in a **cash outflow**, impacting the firm's cash balance. **Issuing shares** is a financing activity that brings in cash. **Amortization of goodwill** and **depreciation** are non-cash expenses and do not appear as direct cash outflows.

27  **Answer:** C) Fixed deposits (maturing in 1 year)

 **Explanation: Cash equivalents** include **highly liquid, short-term investments** with maturities of **three months or less** (e.g., treasury bills, marketable securities). A **fixed deposit maturing in 1 year** is a **short-term investment** but **not a cash equivalent** due to its longer maturity.

28  **Answer:** A) Operating Activity

 **Explanation:** The **gain on sale of fixed assets** is included in the **income statement** and is a **non-cash item** in operating activities under the **indirect method**. However, the **actual cash received from the sale** is recorded as an **investing inflow** in the **investing section** of the Cash Flow Statement.

29  **Answer:** B) Investing Activity

 **Explanation: Investing activities** involve **buying and selling fixed assets**. Since land is a **long-term asset**, its purchase is an **investing outflow**. The **cash paid for land reduces liquidity**, making it crucial to monitor investment activities carefully.

30  **Answer:** A) Operating Activity

 **Explanation: Cash received from customers** is a part of the **core business operations** and is recorded as a **cash inflow under operating activities**. It represents the **primary source of revenue** and directly affects the company's cash position.

31  **Answer:** A) Depreciation expense

 **Explanation:** **Depreciation is a non-cash expense**, meaning it **does not involve actual cash movement**. However, under the **indirect method**, it is **added back** to net profit while preparing cash flows.

32  **Answer:** B) Increase in financing cash flow

 **Explanation:** Issuing shares raises capital, leading to **cash inflow under financing activities**. This improves the company's liquidity and financial stability.

33  **Answer:** B) Direct Method

 **Explanation:** The **Direct Method** lists **actual cash inflows and outflows**, showing the **cash transactions** from operating activities. It is more transparent than the **Indirect Method**, which starts with net profit and adjusts for non-cash items.

34  **Answer:** B) Decrease in cash flow from financing activities

 **Explanation:** **Dividend payments** result in **cash outflows from financing activities** as they reduce the company's retained earnings and available cash.

35  **Answer:** A) Operating Activity

 **Explanation:** **Deferred tax liabilities** arise due to temporary tax differences and are included in **operating activities** when adjustments are made for tax expenses.

36  **Answer:** C) Cash Flow to Debt Ratio

 **Explanation:** The **Cash Flow to Debt Ratio** helps assess a company's ability to repay its obligations using cash generated from operations.

37  **Answer:** B) Investing Activity

 **Explanation:** Interest received is classified under **investing activities** as it is related to returns on financial investments.

38  **Answer:** B) It helps assess liquidity

 **Explanation:** The Cash Flow Statement provides insights into a company's **liquidity, financial health, and cash management**, which are crucial for investors.

39  **Answer:** C) Both A and B

 **Explanation:** The **Balance Sheet** and **Profit and Loss Statement** provide data on net income, changes in assets, liabilities, and equity, all of which are required to prepare a Cash Flow Statement.

40  **Answer:** B) Business is facing liquidity issues

 **Explanation:** **Negative cash flow from operations** suggests the company is **spending more cash than it generates**, indicating **poor liquidity or financial trouble**.

41  **Answer:** C) Financing Activity

 **Explanation:** The **repayment of a long-term loan** is a **financing activity** because it involves the outflow of cash for settling a financial obligation. **Financing activities** include raising funds (through debt or equity) and repaying them. This transaction directly impacts a company's financial position by reducing liabilities. If the company frequently repays loans, it must maintain a **strong cash position** to avoid liquidity issues.

42  **Answer:** A) It increases cash from financing activities

 **Explanation:** When a company **issues debentures**, it receives cash from investors, which is recorded as an **inflow under financing activities**. Debentures are a form of long-term borrowing, and their issuance helps businesses **raise capital for expansion**. The company, however, must pay interest on these debentures, which is recorded as an **operating outflow** when paid.

43  **Answer:** B) Decreases cash from operating activities

 **Explanation:** **Accounts receivable** represents the amount customers owe to the company. An increase means that **sales were made on credit, but cash has not been received yet**. As a result, cash inflows decrease, reducing **operating cash flow**. If receivables continue to rise without collection, the company may face **cash shortages despite showing profits** in the income statement.

44  **Answer:** C) It is added back to net profit in operating activities

 **Explanation:** **Depreciation is a non-cash expense**, meaning it does not directly reduce cash. However, under the **indirect method**, it is **added back to net profit** while calculating **cash flow from operating activities** to adjust for non-cash deductions. This ensures that the company's **actual cash position** is accurately represented.

45  **Answer:** D) Not recorded in cash flow

 **Explanation:** Since **shares are issued instead of cash**, no actual **cash movement** occurs, meaning this transaction is **not recorded in the Cash Flow Statement**. However, if cash is paid as part of the acquisition, it will be reported under **investing activities**.

46  **Answer:** B) The cash available after capital expenditures

 **Explanation:** **Free Cash Flow (FCF)** represents the cash a company has left after covering **operating expenses and capital expenditures**. It indicates the company's ability to **reinvest in growth, pay dividends, or reduce debt**. A positive FCF shows **strong liquidity**, whereas a negative FCF suggests that the company may need **external funding**.

47  **Answer:** B) To track cash inflows and outflows

 **Explanation:** The **Cash Flow Statement** helps businesses **monitor liquidity** by detailing **cash movements in operating, investing, and financing activities**. Unlike the **Profit & Loss Statement**, which uses the **accrual system**, the Cash Flow Statement shows **actual cash transactions**, helping in financial planning and risk assessment.

48  **Answer:** B) Cash equivalents are short-term investments with maturities of three months or less

 **Explanation:** **Cash equivalents** are **highly liquid short-term investments** like **treasury bills, money market funds, and commercial papers** that can be **quickly converted into cash**. They differ from actual cash because they earn a small return and are used for temporary cash management.

49  **Answer:** B) Decrease in financing cash flows

 **Explanation:** **Share buyback (repurchase)** involves the company **spending cash to repurchase its own shares** from investors, leading to a **cash outflow in financing activities**. It is often done to **increase share value, return excess cash to shareholders, or improve financial ratios**.

50  **Answer:** B) Increase in accounts payable

 **Explanation:** **Accounts payable** represent **obligations to suppliers**. An increase means that the company has **delayed payments to suppliers**, preserving cash and increasing **cash flow from operating activities**. Conversely, **increases in inventory or accounts receivable** reduce cash flow since they involve outgoing cash.