

Reuben Das

Financial Reporting and Financial Statement Analysis

DSE6.1A

Unit 3

Fund Flow Statement

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Umeshchandra College

Funds flow statement is a statement which describes about the sources of funds and from where those funds are obtained and side by side the applications of funds and for which those funds have been used. The movement of funds will be in the form of inflow or outflow. It can also be said that from where the funds are received and where the funds are utilised. Analysis of the sources of fund and uses of funds will help us to understand impact of transactions on the financial conditions of the business, business policy etc.

According to Smith and Brown - "Funds Flow Statement is prepared to indicate in summary form, changes occurring in items of financial position between two different balance sheet dates."

The term 'Fund flow' may happen due to transfer of one asset to another asset, one liability to another liability, assets to liabilities, liabilities to assets, combination of these or even the changes in working capital. Normally, an increase in liability or a decrease in assets of the firm is considered as source of funds, on the other hand, an increase in assets or decrease in liabilities is considered as use or application of funds.

Though different thoughts are there regarding the meaning of funds like cash concept, total resources concept, working capital concept but the most widely accepted concept is the working capital concept of fund. As per working capital concept funds mean the net working capital i.e. current assets minus current liabilities. Source of fund and application of fund shows, between two financial years or dates, what the reasons behind the changes are in net working capital.

Under current assets and current liabilities there are transactions for which working capital faces no impact or changes. For example, if cash is realised from a bill receivable then cash balance goes up though, but at the same time the bill receivable balance also goes down by the same value. Which means working capital is facing no impact. Another example may be making payment to a creditor and here also cash balance, which is a part of current asset, goes down and at the same time creditor balance, which is a part of current liability, also goes down and ultimately no impact will be there on working capital. This means these items do not show impact on source and application of funds.

Those items which do not impact working capital:

Increase in one current asset and decrease in another current asset of equal amount; equal amount of increase/decrease in one current liability and decrease/increase in another current liability; increase in one current asset and another current liability of equal amount; amount of decrease in one non-current liability by an equal

amount of increase in other non-current liability; decrease in one current asset and one current liability of equal amount; increase in one non-current asset and one non-current liability of equal amount.

Some examples of these are payment made to creditor; received from debtor; converting one fixed asset into another fixed asset; conversion of debenture into share; purchase of stock or sale of stock in cash or credit etc.

Those items which do impact working capital:

Sale of fixed asset; issue of shares and debentures; redemption of share or debenture; sale of non-current asset; fixed asset purchase; tax payment; dividend payment; purchase of non-current asset etc.

Impact on working capital = when ca↑ wc↑; when ca↓ wc↓ when cl↑ wc↓; when cl↓ wc↑

	current asset	-	current liability	=	working capital
<b>2009</b>	<b>100</b>		<b>50</b>		<b>50</b>
If in 2010	120↑		50		70↑
If in 2010	80↓		50		30↓
<b>2009</b>	<b>100</b>		<b>50</b>		<b>50</b>
If in 2010	100		70↑		30↓
If in 2010	100		30↓		70↑

The analysing of flow of funds involves the following steps:

1. Analysing/schedule of changes in working capital
2. Computing funds from operations
3. Identifying sources and applications of funds

Schedule of changes in working capital

It is the statement prepared for the purpose of the changes in each item of the current asset and the current liability and its effect to the change in the total working capital. The effect of the changes in the individual items of the current assets and current liabilities on the working capital is also shown here. The difference in the amount of working capital at the end of two years will show either the increase or decrease in working capital.

Schedule of Changes in Working Capital  
For the Year Ending .....

Particulars	Previous Year Rs.	Current Year Rs.	Change in Working Capital Increase Rs.	Change in Working Capital Decrease Rs.
<b>CURRENT ASSETS</b>				
Cash in hand				
Cash at Bank				
Sundry Debtors				
Bills Receivable				
Stock or Inventory				
Short term Investments				
<b>Total current assets (A)</b>				

<b>CURRENT LIABILITIES</b>				
Sundry Creditors				
Bills Payable				
Bank Overdraft				
Income received in advance				
<b>Total current liabilities (B)</b>				
<b>NET WORKING CAPITAL</b>				
<b>(A)-(B)</b>				
<b>Increase/Decrease in Working Capital (Balancing Figure)</b>				
Total				

### Computing funds from operations

The fund from operation can be ascertained by preparing our Profit & loss account taking into consideration the item which involve to the normal operation of business. Revenue transactions such as depreciation, profit or loss on sale of assets, etc. appearing in the profit and loss account does not belong to either current or non-current category. All such non-operating incomes and non-operating expenses appear in adjusted profit and loss account to ascertain the funds from operations. Profit earned by the concern during the current year is deemed to be the source of funds. It is a very important source of funds inflow. Net profit is arrived at by deducting cost of goods sold and other expenses from the total sales revenue. There are many items which are debited or credited in the profit and loss account that do not affect working capital. Therefore, in calculating the funds from operations, the following adjustments must be kept in mind:

1. Items to be added back to net profit
2. Non-fund revenue deductions
3. Non-trading charges or losses
4. Items that are to be deducted from net profit
5. Dividend received or receivable
6. Retransfer of excess provisions
7. Profit on sale of non current assets
8. Appreciation in fixed assets

### Fund from operation (format)

Fund from operation	Amount Rs.
Closing Balance of P&L or Retained Earning (as given In the balance sheet)	
Add Non-fund and Non-operating items which have been already debited to P & L A/c :	
(i) Depreciation	
(ii) Authorization of fictitious and intangible assets such as:	
(a) Goodwill	

<p>(b) Patents</p> <p>(c) Trade marks</p> <p>(d) Preliminary Expenses</p> <p>(e) Discount on Issue of Shares, etc.</p> <p>(iii) Appropriation of Retained Earnings, e.g.</p> <p>(a) Transfer to General reserve</p> <p>(b) Dividend Equalisation fund</p> <p>(c) Contingency Reserve, etc.</p> <p>(iv) On sale of any non-current (fixed) assets such as :</p> <p>(a) Loss on sale of land and building</p> <p>(b) Loss on sale of machinery</p> <p>(c) Loss on sale of furniture</p> <p>(d) Loss on sale of long-term investments, etc.</p> <p>(v) Dividends including :</p> <p>(a) Interim Dividend</p> <p>(b) Proposed Dividend (if it is an appropriation of profits and not taken as current liability)</p> <p>(vi) Provision for taxation (if it is not taken as Current Liability)</p> <p>(vii) Any other non-fund/non-operating Items which have been debited to P /L</p> <p><b>Total (A)</b></p> <p>Less Non-fund or Non-operating items which have already been credited to P&amp;L A/c</p> <p>(i) Profit or Gain from the sale of non-current (fixed) assets such as : (a) Profit on sale of land and building</p> <p>(b) Profit on sale of plant and machinery</p> <p>(c) Profit on sale of long-term investments, etc.</p> <p>(ii) Appreciation in the value of fixed assets, such as increase in The value of land If It has been credited to P /L A/c</p> <p>(iii) Dividends Received</p> <p>(iv) Excess Provision retransferred to P/L A/c or written off</p> <p>(v) Any other non-operating Item which has been credited to P/L A/c</p> <p>(vi) Opening balance of P/L A/c or Retained Earnings (as given In the balance sheet)</p> <p><b>Total (B)</b></p> <p><b>Total (A) - Total (B) = Funds from operations.</b></p>	
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It can also be created with the help of adjusted profit and loss account(format)

Dr	Adjusted Profit and Loss a/c	Cr
Particulars	Amount Rs.	Particulars
Amount Rs.		Amount Rs.

To Depreciation written off Preliminary exp written off Goodwill written off Discount on issue of shares Loss on sale of fixed assets Loss on sale of trade investments Transfer to General Reserve Provision for Tax Provision for Proposed Dividend Balance c/d (Net Profit) (Closing balance)		By Balance b/d (Opening balance ) Profit on sale of investments Profit on sale of fixed assets Dividend and interest received Funds from Operations (balance figure)	

**FUNDS FLOW STATEMENT (horizontal format)**  
**(STATEMENT OF SOURCES AND APPLICATION OF FUNDS)**

Sources of Funds	Amount Rs.	Application of Funds	Amount Rs.
Issue of Equity Shares		Purchase of Fixed Assets	
Issue of Preference shares		Purchase of Investments	
Issue of Debentures		Redemption of shares	
Loan taken		Redemption of debenture	
Sale of Fixed Assets		Payment of loan	
Sale of Investments		Payment of Tax	
Non-trading incomes		Payment of Dividend	
Fund from Operation (profit)		Non-trading losses	
Decrease of working capital		Increase of working capital	
		Fund from operation (loss)	

**FUNDS FLOW STATEMENT (vertical format)**  
**(STATEMENT OF SOURCES AND APPLICATION OF FUNDS)**

Particular	Amount	Amount
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	Rs.	Rs.
<b>Sources of Funds:</b>		
Issue of Equity Shares		
Issue of Preference shares		
Issue of Debentures		
Loan borrowed		
Sale of Fixed Assets		
Sale of Investments		
Non-trading incomes		
Fund from Operation (profit)		
Decrease of working capital		
<b>Total (A)</b>		
<b>Application of Funds:</b>		
Purchase of Fixed Assets		
Purchase of Investments		
Redemption of shares		
Redemption of debenture		
Payment of loan		
Payment of Tax		
Payment of Dividend		
Non-trading losses		
Increase of working capital		
Fund from operation (loss)		
<b>Total (B)</b>		

Provision for Taxation: It can be treated in the following two ways:

1. Treated as current liability – When there is no income tax paid or additional provision made, it is treated as current liability. It can be taken to schedule of changes in working capital. No further treatment is required.
2. Treated as non-current liability – A ledger account (provision for taxation a/c) is prepared. Sometimes we may have to arrive at income tax paid during the year from the given information. These are hidden transactions which are not apparent and are hidden.

Proposed Dividend: It can be treated in the following two ways:

1. Treated as current liability – Proposed dividend can be taken as current liability because declaration of dividends by shareholders is simply a formality. It is taken to schedule of changes in working capital with no further treatment.
2. Treated as non-current liability – Proposed dividend can be taken as an appropriation of profit. In such a case, proposed dividend for the current year will be added back to the current year's profit. This helps in finding funds from operations, if such amount of dividend has already been charged to profit. Payment of dividend will be shown as an application of fund.

Limitations of Fund Flow Statement

- It ignores to project future operations.
- It also ignores transactions when they occur between current accounts and non-current accounts.
- It does not provide any additional information to the management as financial statements are simply rearranged and presented.
- It is not ideal tool for financial analysis.

Following is the balance sheet of A ENTERPRISE:

Balance Sheet as on 31st March

<b>Liabilities</b>	<b>2017</b>	<b>2018</b>
Share Capital	2,00,000	2,50,000
General Reserve	50,000	60,000
Profit and Loss	30,500	30,600
Bank Loan (long-term)	70,000	-
Sundry Creditors	1,50,000	1,35,200
Provision for Taxation	30,000	35,000
<b>Total</b>	<b>5,30,500</b>	<b>5,10,800</b>
<b>Assets</b>		
Land and Building	2,00,000	1,90,000
Machinery	1,50,000	1,69,000
Stock	1,00,000	74,000
Sundry Debtors	80,000	64,200
Cash	500	600
Bank	-	8,000
Goodwill	-	5,000
<b>Total</b>	<b>5,30,500</b>	<b>5,10,800</b>

Additional Information: During the year ended 31st December, 2018

1. Dividend of Rs.23,000 was paid
2. Assets of another company were purchased for a consideration of Rs.50,000 payable in shares. The assets include stock Rs.20,000, machinery Rs.25,000
3. Machinery was further purchased for Rs.8000
4. Depreciation written off on machinery Rs.12,000
5. Income tax provided during the year Rs.33,000
6. Machinery worth Rs.2000 was sold for Rs.1800. Loss on sale of machinery Rs.200 was transferred to general reserve.

Prepare the schedule of changes in working capital and funds flow statement.

Schedule of Changes in Working Capital

Particulars	2017 Rs.	2018 Rs.	Change in Working Capital Increase Rs.	Change in Working Capital Decrease Rs.
<b>CURRENT ASSETS</b>				
Stock	1,00,000	74,000		26,000
Sundry Debtors	80,000	64,200		15,800
Cash	500	600	100	
Bank	-	8,000	8,000	

<b>Total current assets (A)</b>	<b>1,80,500</b>	<b>1,46,800</b>		
<b>CURRENT LIABILITIES</b>				
Sundry Creditors	1,50,000	1,35,200	14,800	
<b>Total current liabilities (B)</b>	<b>1,50,000</b>	<b>1,35,200</b>		
<b>NET WORKING CAPITAL (A)-(B)</b>	<b>30,500</b>	<b>11,600</b>		
<b>Increase/Decrease in Working Capital (Balancing Figure)</b>		<b>18,900</b>	<b>18,900</b>	
<b>Total</b>	<b>30,500</b>	<b>30,500</b>	<b>41,800</b>	<b>41,800</b>

Dr Adjusted Profit and Loss A/c Cr

Particulars	Amount Rs.	Particulars	Amount Rs.
To Depreciation on Land and Building	10,000	By Balance b/d	30,500
To Depreciation on Machinery	12,000	By Funds from Operation	88,300
To General Reserve	10,200	(Balancing Figure)	
To Provision for Taxation	33,000		
To Dividend	23,000		
To Balance c/d	30,600		
	<b>1,18,800</b>		<b>1,18,800</b>

Funds Flow Statement

Sources	Amount Rs.	Applications	Amount Rs.
Sale of Machinery	1,800	Purchase of Machinery	8,000
Issue of Shares [Purchase of Stock]	20,000	Payment of Dividend	23,000
Funds from Operation	88,300	Income Tax paid	28,000
Decrease in Working Capital		Repayment of Loan	70,000
[Balancing Figure]	18,900		
	<b>1,29,000</b>		<b>1,29,000</b>

Dr Land and Building A/c Cr

Particulars	Amount Rs.	Particulars	Amount Rs.
To balance b/d	2,00,000	By adjusted P/L A/c-Depreciation	10,000
		By Balance c/d	1,90,000
	2,00,000		2,00,000

Dr Machinery A/c Cr

Particulars	Amount Rs.	Particulars	Amount Rs.
To balance b/d	1,50,000	By adjusted P/L A/c-Depreciation	12,000
To Share Capital A/c	25,000	By Gen. Reserve A/c [Loss on Sale]	200
[Purchase of Shares]		By Cash A/c [Sale]	1,800



To Cash A/c [Purchase]	8,000	By Balance c/d	1,69,000
	1,83,000		1,83,000

Dr		Goodwill A/c		Cr	
Particulars	Amount Rs.	Particulars	Amount Rs.		
To balance b/d	-	By Balance c/d	5,000		
To Share Capital A/c [Purchase consideration]	5,000				
	5,000		5,000		

Dr		Share Capital A/c		Cr	
Particulars	Amount Rs.	Particulars	Amount Rs.		
To Balance c/d	2,50,000	By Balance b/d	2,00,000		
		By Stock A/c	20,000		
		By Machinery A/c	25,000		
		By Goodwill A/c (purchase consideration)	5,000		
	2,50,000		2,50,000		

Dr		General Reserve A/c		Cr	
Particulars	Amount Rs.	Particulars	Amount Rs.		
To Machinery A/c	200	By Balance b/d	50,000		
To Balance c/d	60,000	By adjusted P/L A/c	10,200		
	60,200		60,200		

Dr		Bank loan A/c		Cr	
Particulars	Amount Rs.	Particulars	Amount Rs.		
To cash A/c (repayment of loan)	70,000	By Balance b/d	70,000		
To Balance c/d	-				
	70,000		70,000		

Dr		Provision for tax A/c		Cr	
Particulars	Amount Rs.	Particulars	Amount Rs.		
To cash A/c (tax paid)(balancing figure)	28,000	By Balance b/d	30,000		
To Balance c/d	35,000	By Adjusted P & L A/c	33,000		
	63,000		63,000		