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Lecture-5

Fund Flow Statement

Fund Flow Statement

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Objectives

After studying this Chapter, you will be able to:

Explain the meaning of fund flow statement

Prepare the statement of changes in working capital

Construct fund flow statement

Introduction

Every business establishment usually prepares the balance sheet at the end of the fiscal year which highlights the financial position of the yester years It is subject to change in the volume of the business not only illustrates the financial structure but also expresses the value of the applications in the liabilities side and assets side respectively. Normally, Balance sheet reveals the status of the firm only at the end of the year, not at the beginning of the year. It never discloses the changes in between the value position of the firm at two different time periods/dates.

The method of portraying the changes on the volume of financial position is the analysis of fund flow statement.

5.1 Meaning of Fund Flow Statement

In a narrow sense, the term fund means cash, and the fund flow statement depicts the cash receipts and cash disbursements/payments. It highlights the changes in the cash receipts and payments as a cash flow statement in addition to the cash balances i.e. opening cash balance and closing cash balance. Contrary to the earlier, the fund means working capital, i.e. the differences between the current assets and current liabilities.

The term flow denotes the change. Flow of funds means the change in funds or in working capital. The change on the working capital leads to the net changes taken place on the working capital, i.e. especially due to either increase or decrease in the working capital. Some of the transactions may lead to increase or decrease the volume of working capital. Some other transactions register neither an increase nor decrease in the volume of working capital.

According to Foulke, "A statement of source and application of funds is a technical device designed to analyse the changes to the financial condition of a business enterprise in between two dates."

Various facets of fund flow statement are as follows:

1. Statement of sources and application of funds
2. Statement changes in financial position
3. Analysis of working capital changes and
4. Movement of funds statement
5. Depreciation charged on assets
6. Appropriation of profits to reserves
7. Payment of interim dividends
8. Payment and appropriations in relation to provisions for taxation/dividends where they are treated as non-current liabilities.

Fund flow statement has following objectives:

1. It pinpoints the mobilization of resources and the further utilization of resources.
2. It highlights the financing of the general expansion of the business firms.
3. It exemplifies the utilization of debt finance in the structure of financing.
4. It portrays the relationship between the financing, investments, liquidity and dividend decision of the firm during the given point of time.

Notes Steps in the Preparation of Fund Flow Statement:

First and foremost step is to prepare the statement of changes in working capital, i.e. to identify the flow of fund/movement of fund through the detection of changes in the volume of working capital.

Second step is the preparation of Non-current A/c items-Changes in the volume of Non-current A/cs have to be prepared only in order to quantify the flow fund, i.e. either sources or application of fund.

Third step is the preparation Adjusted Profit & Loss A/c, which already elaborately discussed in the early part of the Chapter.

Last step is the preparation of fund flow statement.

Self Assessment

Fill in the blanks:

The fund flow statement depicts the ………………… receipts and cash disbursements/ payments.

Fund flow means a study of …………………

5.2 Preparation of Statement of Changes in Working Capital

Notes

The ultimate purpose of preparing the schedule of changes in the working capital illustrates the changes in the volume of net working capital which envisages either sources or application of fund. The schedule of changes is focused as follows:

Increase in Current Assets	Increase in Working Capital
Decrease in Current Assets	Decrease in Working Capital
Increase in Current Liabilities	Decrease in Working Capital
Decrease in Current Liabilities	Increase in Working Capital

Particulars	Previous Year	Current Year	Increase in Working Capital (+)	Decrease in Working Capital (-)
(A) Current Assets:				
Cash in Hand				
Cash at Bank				
Marketable Securities				
Bills Receivable				
Sundry Debtors				
Closing Stock				
Prepaid Expenses				
(B) Current Liabilities:				
Creditors				
Bills Payable				
Outstanding expenses				
Pre received Income				
Provision for doubtful and bad debts				
Net Working Capital(A-B)				
Increase/Decrease Working Capital				

Example: From the following details prepare a statement showing changes in working capital during 2006.

Balance Sheet of Pioneer Ltd
as on 31st December

Liabilities	2005 (`)	2006 (`)	Assets	2005 (`)	2006 (`)
Share capital	5,00,000	6,00,000	Fixed assets	10,00,000	11,20,000
Reserves	1,50,000	1,80,000	Less: Depreciation	3,70,000	4,60,000
Profit and Loss A/c	40,000	65,000		6,30,000	6,60,000
Debentures	3,00,000	2,50,000	Stock	2,40,000	3,70,000
Creditors for goods	1,70,000	1,60,000	Book Debts	2,50,000	2,30,000
Provision for tax	60,000	80,000	Cash in hand	80,000	60,000

Contd...

Notes

			Preliminary expenses	20,000	15,000
	12,20,000	**13,35,000**		**12,20,000**	**13,35,000**

Solution: Schedule of Changes in Working Capital

	2005	**2006**	**Increase in Working Capital**	**Decrease in Working Capital**
Current Assets:				
Stock	2,40,000	3,70,000	1,30,000	–
Book debts	2,50,000	2,30,000	–	20,000
Cash in hand	80,000	60,000	–	20,000
	5,70,000	6,60,000	1,30,000	40,000
Current Liabilities:				
Creditors for goods	1,70,000	1,60,000	10,000	–
Working capital	4,00,000	5,00,000	1,40,000	40,000
Increase in working capital	1,00,000	–	–	1,00,000
	5,00,000	5,00,000	1,40,000	1,40,000

Self Assessment

State whether the following statements are true or false:

Normally, working capital means current assets.

Increase in current assets means increase in working capital.

Purchase of plant and machinery ` 10 lakh through the issue of 1 Lakh shares at ` 10 per share; affect the non-current asset and current liabilities accounts.

XYZ Ltd. has made a credit purchase of ` 1 lakh worth of goods led to ` 1 lakh worth of additional stock of tradable goods for the enterprise, leads to increase in the working capital.

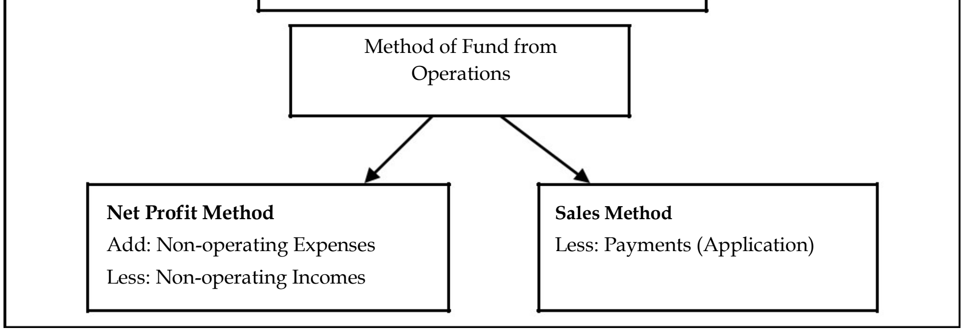
5.3 Preparing Funds from Operations

The following are the key methods of preparing fund from operations:

Net Profit Method

Sales Method

Figure 5.1 Methods of Funds from Operations



Notes

Caution The first method is widely used method by all in determining the volume of Fund from Operations (FFO).

5.3.1 Net Profit Method

Under the Net Profit Method, fund flow from operations can be computed. Under this method, fund from operations can be determined in two different ways The first method is through the statement format

Net Profit from the Profit & Loss A/c		xxxxx
Add:		
	Non-funding Expenses:	
	Loss on Sale of Fixed Assets	xxxx
	Loss on Sale of Long-term Investments	xxxx
	Loss on Redemption Debentures/Preference Shares	xxxx
	Discount on Debentures/Share	xxxx
2.	***Non-operating Expenses:***	
	Depreciation of Fixed Assets	xxxx
	Intangible Assets:	
	Amortization of Goodwill	xxxx
	Amortization of Patent	xxxx
	Amortization of Trade Mark	xxxx
4.	***Fictitious Assets:***	
	Writing off Preliminary Expense	xxxx
	Writing off Discount on Shares/Debentures	xxxx
	Profit Appropriation	
	Transfer to General Reserve	xxxx
	Less:	
	Non-funding Profits:	
	Profit on Sale of Fixed Assets	xxxx
	Profit on Sale of Long-term Investments	xxxx
	Profit on Redemption Debentures/Preference Shares	xxxx
7.	***Non-operating Incomes:***	
	Dividend Received	xxxx
	Interest Received	xxxx
	Rent Received	xxxx
	Fund From Operations/Fund Lost in Operations	xxxxx

Notes

The second method of determining the fund from operations under the first classification is the Accounting Statement Format

Adjusted Profit & Loss A/c

Dr			Cr
To Depreciation	xxxx	By Opening Balance Profit	Xxxx
To Goodwill Written off	xxxx	By Profit on Sale of Fixed Assets	Xxxx
To Patent Written off	xxxx	By Profit on Sale of Investments	Xxxx
To Loss on Sale of Fixed Asset	xxxx	By Profit on Redemption of Liability	Xxxx
To Loss on Sale of Investment	xxxx	By Transfer from General Reserve	Xxxx
To Loss on Redemption of Liability	xxxx	By Balancing Figure fund from Operations (FFO)	Xxxx
To Preliminary Expenses off	xxxx		
To Proposed Dividend	xxxx		
To Transfer to General Reserve	xxxx		
To Current Year Provision for Taxation	xxxx		
To Current Year Provision for Depreciation	xxxx		
To Balancing Figure (Fund Lost in Operations)	xxxx		

5.3.2 Sales Method

Under this method, the following is the statement format is used to arrive fund flow from operations.

Sources:

Sales	xxxxx
Stock at the end	xxxxx
Less:	

Application:

Stock at Opening	xxxx
Net Purchases(Purchase-Returns)	xxxx
Wages	xxxx
Salaries	xxxx
Telephone expenses	xxxx
Electricity charges	xxxx
Office stationery expenses	xxxx
Other operating cash expenses	xxxx
Fund from Operations	xxxx

Notes

Example: From the following details calculate funds from operations:

	`
Salaries	10,000
Rent	6,000
Refund of Tax	6,000
Profit on Sale of Building	10,000
Depreciation on Plant	10,000
Provision for Taxation	8,000
Loss on Sale of Plant	4,000
Closing Balance of Profit & Loss A/c	1,20,000
Opening Balance on Profit & Loss A/c	50,000
Discount on Issue of Debentures	4,000
Provision for Bad Debts	2,000
Transfer to General Reserve	2,000
Preliminary Expenses written off	6,000
Goodwill written off	4,000
Dividend Received	10,000
Proposed Dividend	12,000

Solution:

Calculation of fund from operation

First Method

Closing Balance of Profit & Loss A/c	1,20,000
Less: Opening Balance	50,000
Balance Forward	70,000
Add: Non-fund/Non-operating Charges	
Depreciation on Plant	10,000
Provision for Taxation	8,000
Loss on Sale of Plant	4,000
Discount on Issue of Debentures	4,000
Provision for Bad Debts	2,000
Transfer to General Reserve	2,000
Preliminary Expenses off	6,000
Goodwill Written off	4,000
Proposed Dividend	12,000
	1,22,000

Notes

Less: Refund of Tax	6,000
Profit on Sale of Building	10,000
Dividend Received	10,000
Fund from Operations	96,000

Second Method:

Adjusted Profit & Loss A/c

To Depreciation on Plant	10,000	By Opening Balance b/d	50,000
To Provision for Taxation	8,000	By Profit on Sale of Building	10,000
To Loss on Sale of Plant	4,000	By Dividend Received	10,000
To Discount on issue of debentures	4,000	By Refund of Tax	6,000
To Provision for bad debts	2,000	By Balancing Figure	96,000
To Transfer to general reserve	2,000	Fund from Operations	
To Preliminary expenses off	6,000		
To Goodwill written off	4,000		
To Proposed Dividend	12,000		
To Closing Profit c/d	1,20,000		
	1,72,000		**1,72,000**

Task Discuss any non-current account transactions affecting the fund position of a firm of your choice..

Self Assessment

Choose the appropriate answer

Adjusted profit and loss account is prepared for

Determining the fund from operations

Determining the fund lost in operations

Either (a) or (b)

None of the above

Fund flow statement is categorized into two parts

Fund inflow and Fund outflow

Cash inflow and Cash outflow

Sources and Applications

None of the above

Fund from operations is

Sources of the firm

Applications of the firm

(c) Neither sources nor applications

None of the above

Notes

5.4 Preparing Fund Flow Statement

The next step is to prepare the fund flow statement. The proforma of the fund flow statement:

Sources of Funds	Uses of Funds
Funds from Business Operation	Funds Lost in Operations
Non-trading Incomes	Redemption of Preference Share Capital
Sale of Non-current Assets	Repayment of Loans
Sale of Long-term Investments	Purchase of Long-term Investments
Issue of Shares	Purchase of Fixed Assets
Acceptance of Deposits	Payment of Taxes
Long-term Borrowings	Payment of Dividends
Decrease in Working Capital	Drawings
	Loss of Cash
	Increase in Working Capital

Important Adjustments

Provision for Tax: At the time of preparation of fund flow statement, there are two approaches to treat this item. These are:

Treat it as a current liability

Treat it as an appropriation of profit

As per first approach, the provision for taxation is assumed as a current liability. Therefore, it must be shown in the schedule of working capital changes. All the information relating taxation should be ignored as in the case of other current liabilities. In this approach, the provision, for taxation is neither used in the fund from operation nor in the uses of fund in the Fund Flow Statement as payment of tax liability.

Under second approach, the provision for taxation is treated as an appropriation of profit. Provision for taxation is not shown in the Schedule of Working Capital Changes. As other appropriations it is added back in the net profits to calculate the Fund from Operation. To find the payment of tax of the year provision for taxation account is prepared. Payment of the tax of the year is disclosed in the Uses of Fund in the Fund Flow Statement. Provision for taxation a/c is prepared as hereunder:

Provision for Taxation

	`		`
To Cash (Payment of tax)	-	By balance b/d	-
(Balancing figure)		By P & L a/c (current year's provision)	-
To balance c/d	-		
	–		–

However, it is advised to the students to adopt the first approach. This approach is more convenient for the students. Provision for taxation is also disclosed under the heading of current liabilities and provisions in the Balance Sheet of the Company as per the Indian Companies Act. This approach is adopted in the book also.

Notes

2. ***Proposed Dividend and Dividend Paid:*** Dividend paid during the year should be treated as an application of fund, therefore, it must be shown in the fund flow statement. Proposed dividend is not accumulated therefore, it should not be treated as a current liability. It is assumed that the proposed dividend of the previous year is paid during the year whether it is said or not. Therefore, it will be a use of fund. Proposed dividend and interim dividend are the appropriations against profit. So to calculate the fund from operation it must be added back to net profits like other appropriations. It must be noted that the closing balance of the P & L account of a year should be equal to the opening balance of P & L A/c in the next year. If there is any difference between these two figures, difference should be treated as payment of dividend during the year.

3. ***Depreciation of the Assets:*** It is an item considered to be non-recurring expenditure. It was considered at par with the other expenditures/expenses which do not reduce the volume of working capital. The charge of depreciation never indulges in the payment of cash resources from the firm.

   Writing off Fictitious and Intangible Assets:

Fictitious Assets	Intangible Assets
Preliminary expenses	Goodwill
Discount on issue of shares/ debentures	Patents
	Trade Mark

The writing off of the above enlisted item of fictitious and intangible assets do not involve any payments.

Example: From the following relating to Panasonic Ltd., prepare funds flow statement.

Balance Sheet of Panasonic Ltd.
as on 31st December

Liabilities	2005 (`)	2006 (`)	Assets	2005 (`)	2006 (`)
Share capital	6,00,000	8,00,000	Fixed assets	3,80,000	4,20,000
Reserves	2,00,000	1,00,000	Accounts receivable	2,10,000	3,00,000
Retained earnings	60,000	1,20,000	Stock	3,00,000	3,90,000
Accounts payable	90,000	2,70,000	Cash	60,000	1,80,000
	9,50,000	**12,90,000**		**9,50,000**	**12,90,000**

Additional Information:

The company issued bonus shares for ` 1,00,000 and for cash ` 1,00,000.

Depreciation written off during the year ` 30,000.

Solution:

The first step is prepare the statement of changes in working capital.

Schedule of Changes in Working Capital

	2005	2006	Increase in Working Capital	Decrease in Working Capital
Total Current Assets (A): (TCA)				
Cash	60,000	1,80,000	1,20,000	–
Stock in trade	3,00,000	3,90,000	90,000	–
Accounts receivable	2,10,000	3,00,000	90,000	–
	5,70,000	8,70,000		

Contd…

Notes

Total Current Liabilities (B): (TCL)				
Accounts payable	90,000	2,70,000		1,80,000
Working capital (A-B)	4,80,000	6,00,000	3,00,000	1,80,000
Increase in working capital	1,20,000			1,20,000
	6,00,000	6,00,000	3,00,000	3,00,000

The next step is to prepare the non-current account.

First non-current asset account should have to be prepared.

Dr **Fixed Assets A/c** Cr

Particulars	`	Particulars	`
To Balance b/d	3,80,000	By Depreciation (Adjusted Profit &Loss A/c)	30,000
To Cash (Purchase) Balancing fig.	70,000	By Balance c/d	4,20,000
	4,50,000		**4,50,000**

The next non-current account is that non-current liability which is nothing but Share capital

Dr **Share Capital A/c** Cr

Particulars	`	Particulars	`
To Balance c/d	8,00,000	By Cash (Issue of shares)	1,00,000
		By General reserve	1,00,000
		By Balance b/d	6,00,000
	8,00,000		**8,00,000**

And another non-current account is to be prepared that general reserve account.

Dr **General Reserve A/c** Cr

Particulars	`	Particulars	`
To Share capital	1,00,000	By Balance b/d	2,00,000
To Balance c/d	1,00,000		
	2,00,000		**2,00,000**

The next step is to prepare the Adjusted Profit & Loss A/c.

Dr **Adjusted Profit & Loss A/c** Cr

Particulars	`	Particulars	`
To (Fixed Assets) depreciation	30,000	By Balance b/d (Retained Earnings)	60,000
To Balance c/d	1,20,000	By Fund from operation Balancing fig.	90,000
	1,50,000		**1,50,000**

The next step is to prepare the fund flow statement of the enterprise.

Fund Flow Statement

Sources	`	Applications	`
Issue of Shares	1,00,000	Purchase of Land	70,000
Funds from operation	90,000	Increase in working capital	1,20,000
	1,90,000		**1,90,000**

Notes

Solved Problems for Practice

Balance sheets of M/s Black and White as on 1-1-2006 and 31-12-2006 were as follows:

Balance Sheet

Liabilities	1-1-06 `	31-12-06 `	Assets	1-1-06 `	31-12-06 `
Creditors	40,000	44,000	Cash	10,000	7,000
Mrs.Whites'Loan	25,000	-	Debtors	30,000	50,000
Loan from P.N.Bank	40,000	50,000	Stock	35,000	25,000
Captial	1,25,000	1,53,000	Machinery	80,000	55,000
			Land	40,000	50,000
			Building	35,000	60,000
	2,30,000	**2,47,000**		**2,30,000**	**2,47,000**

Additional Information:

During the year, machine costing `10,000 (accumulated depreciation `3,000) was sold for `5,000. The provision for depreciation against machinery as on 1-1-2006 was `25,000 and on 31-12-2006 `40,000. Net profit for the year 2006 amounted to `45,000. You are required to prepare funds flow statement.

The very first step is to prepare the statement of changes in working capital.

Changes in working capital between the various current assets and current liabilities are as follows:

Current Assets:

Cash

Debtors

Stock

Current Liabilities:

Sundry creditors

Statement of changes in Working Capital

	1-1-2006 `	31-12-2006 `	Increase in Working Capital	Decrease in Working Capital
Current Assets:				
Cash	10,000	7,000	-----------	3,000
Debtors	30,000	50,000	20,000	----------
Stock	35,000	25,000	---------	10,000
	75,000	82,000		
Current Liability:				
Sundry creditors	40,000	44,000	-----------	4,000
Working capital	35,000	38,000	20,000	17,000
Increase in working capital	3,000			3,000
	38,000	38,000	20,000	20,000

The next step is to determine the cost of the machinery before the charge of depreciation i.e. to find out the Gross value of the assets. In other, words, original cost of the assets to be found out at the moment of purchase.

Notes

	1-1-2006	31-12-2006
Written down value of the machinery extracted from the balance sheet as on dated	`80,000	`55,000
Add: Accumulated depreciation or Provision for depreciation	25,000	40,000
Original Cost of Machinery	1,05,000	95,000

The ultimate aim is to find out the original cost of the machinery for the preparation of the machinery account.

Before preparing the Machinery account, the worth of the sale transaction of the machinery should be found out.

Original cost of the Machinery	`10,000
(-) Depreciation	`3,000
Machinery worth for sale	`7,000
(-) Machinery sold	`5,000
Loss on sale of the portion of the machinery sold	`2,000

The entry for the loss on sale of machinery sold

Loss on sale a/c Dr	`2,000
To Machinery a/c	`2,000

The next entry is for the adjusted profit and loss account.

Adjusted Profit & Loss A/c Dr	`2,000
To Loss on sale a/c	`2,000

Dr **Machinery A/c** Cr

Particular	`	Particulars	`
To Balance B/d	1,05,000	By Cash (Sales)	5,000
		By Provision for Depreciation	3,000
		By loss on sale(Adjusted profit and loss account)	2,000
		By Balance c/d	95,000
	1,05,000		**1,05,000**

The next one is the provision for depreciation account or accumulated depreciation account.

Dr **Provision for Depreciation A/c** Cr

Particulars	`	Particulars	`
To Machinery A/c	3,000	By Balance B/d	25,000
To Balance c/d	40,000	By depreciation provided during the current year	18,000
	43,000		**43,000**

The next non-current liability account to be prepared is that capital account.

In the additional information net profit for the year 2006 ` 45,000 is given.

Net profit is transferred to capital account.

Why the net profit is transferred to capital account?

Notes

Income earned in the form of net profit should be added to the capital account.

Net profit A/c Dr ` 45,000

To Capital A/c ` 45,000

Dr **Capital A/c** Cr

Particulars	`	Particulars	`
To Drawings (Balancing fig.)	17,000	By Balance B/d	1,25,000
To Balance c/d	1,53,000	By Net profit	45,000
	1,70,000		**1,70,000**

At the end of the year, the total volume of the capital should be equivalent to `1,70,000 but it amounts ` 1,53,000. It is only due to the personal drawings of the owner of the enterprise.

The next non-current liability account is loan from P.N. Bank.

The closing volume of the loan is more than the opening balance of loan; it means that the firm has recently borrowed an amount of `10,000 in addition to opening balance of the loan borrowings.

While borrowing, what happens in the firm?

Debit what comes in - Cash resources are coming inside the business.

Credit the giver/liabilities - Register the name of the banker who is nothing but the giver of the loan.

Dr **Loan P.N. Bank A/c** Cr

Particulars	`	Particulars	`
		By Balance B/d	40,000
To Balance c/d	50,000	By Cash (Balancing fig)	10,000
	50,000		50,000

The next non-current liability is Mr. White's loan amount of `25,000.

The opening balance of the loan amount is greater than the closing balance which amounted to `25,000; it means that the initial loan amount was paid during the year.

Dr **Mr. White's A/c** Cr

Particulars	`	Particulars	`
To Cash (Loan paid)	25,000	By Balance B/d	25,000
To Balance c/d	----------		
	25,000		25,000

While repaying the loan amount, what happens in the firm?

The name of the party that receives the amount of loan repayment should be mentioned.

Debit the receiver - Cash resources are going out of the firm during the moment of making the repayment of the loan. Credit what goes out of the firm.

The closing balances of the land and building are greater than the opening balances: this means that additional land and building was procured by the firm for its future prospects.

The purchase of the land & building leads to applications -outflow of fund

Notes

The next step is to prepare the Adjusted Profit & Loss Account.

Adjusted Profit & Loss Account

Particulars	`	Particulars	`
To Machinery (Loss on sale)	2,000	By Balance B/d	-----------
To Provision for Depreciation	18,000	By fund from operations	65,000
To Balance c/d (Net profit)	45,000		
	65,000		65,000

The next step is to prepare the fund flow statement.

Fund Flow Statement

Sources	`	Applications	`
Sale of machinery	5,000	Purchase of land	10,000
Loan from P.N.Bank	10,000	Purchase of Building	25,000
Fund from operation	65,000	Drawings	17,000
		Repayment of Mr. White Loan	25,000
		Increase in working capital	3,000
	80,000		**80,000**

From the following balance sheets of A Ltd. on 31st Dec, 2008 and 2009, you are required to prepare fund flow statement.

The following additional information has also been given:

Depreciation charged on plant was `4,000 and on building `4,000.

Provision for taxation of `19,000 was made during the year 2009.

Interim Dividend of `8,000 was paid during the year 2009.

Balance Sheet

Liabilities	2008 `	2009 `	Assets	2008 `	2009 `
Share capital	1,00,000	1,00,000	Goodwill	12,000	12,000
General Reserve	14,000	18,000	Building	40,000	36,000
Profit & Loss A/c	16,000	13,000	Plant	37,000	36,000
Sundry creditors	8,000	5,400	Investments	10,000	11,000
Bills payable	1,200	800	Stock	30,000	23,400
Provision for taxation	16,000	18,000	Bill receivable	2,000	3,200
Provision for doubtful debts	400	600	Debtors	18,000	19,000
			Cash	6,600	15,200
	1,55,600	**1,55,800**		**1,55,600**	**1,55,800**

The following items are considered for the statement of changes in the working capital:

Current Assets:

Stock

Bills receivable

Debtors

Cash

Notes

Current liabilities:

Sundry creditors

Bills payable

Provision for doubtful debts

Provision for Taxation: It is nothing but non-current liability account which extends more than a year in duration.

The first step is to prepare the statement of changes in the working capital.

Statement of changes in Working Capital

	2008 `	2009 `	Increase in Working Capital	Decrease in Working Capital
Current Assets:				
Stock	30,000	23,400		6,600
Bill receivable	2,000	3,200	1,200	
Debtors	18,000	19,000	1,000	
Cash	6,600	15,200	8,600	
	56,600	60,800		
Current Liability:				
Sundry creditors	8,000	5,400	2,600	
Bills payable	1,200	800	400	
Provision for doubtful debts	400	600		200
	9,600	6,800		
Working capital	47,000	54,000	13,800	6,800
Increase in working capital	7,000			7,000
	54,000	54,000	13,800	13,800

The next step is to prepare the non-current accounts.

First, non-current asset account is to be prepared.

The first non-current asset account is the Building account.

Dr **Building Account** Cr

Particulars	`	Particulars	`
To Balance B/d	40,000	By (Depreciation)Adjusted profit & Loss A/c	4,000
		By Balance c/d	36,000
	40,000		**40,000**

The next non- current asset account is the Plant account

Dr **Plant Account** Cr

Particulars	`	Particulars	`
To Balance B/d	37,000	By (Depreciation) Adjusted profit & Loss A/c	4,000
To Cash (Purchase) balancing fig.	3,000	By Balance c/d	36,000
	40,000		**40,000**

To cash balancing figure means that the firm has undergone a purchase of new plant which amounted ` 3,000.

Notes

During the purchase, what happens in the firm?

The cash resources are going out of the firm and plant is coming into the business enterprise.

Debit what comes in - Plant

Credit what goes out - Cash

Plant A/c `3,000

To Cash A/c `3,000

The next non-current asset account is Investment account.

The opening balance is less than that of the closing balance; which means that the firm has made a purchase of investments worth of `1,000. The following is the journal entry:

Investments A/c Dr `1,000

To cash A/c `1,000

Dr **Investments account** Cr

Particulars	`	**Particulars**	`
To Balance B/d	10,000		
To Cash(purchase) Balancing fig	1,000	By Balance c/d	11,000
	11,000		**11,000**

The next one is the non-current liability account. The first non-current liability account is General reserve. The opening balance is less than the closing balance of the general reserve account, which means that some portion of the current year profit is transferred to General reserve. The actual entry is as follows:

Net profit A/c Dr `4,000

To General reserve A/c `4,000

For finding out the fund from operations, the amount which was transferred from the net profit to general reserve should be added back in order to identify the original volume.

Adjusted Profit & Loss A/c `4,000

To General Reserve A/c `4,000

Dr **General Reserve Account** Cr

Particulars	`	**Particulars**	`
		By Balance B/d	14,000
To Balance B/d	18,000	By (Adjusted profit and loss A/c) Profit transferred during the current year	4,000
	18,000		**18,000**

The next non-current liability account is Provision for taxation account.

Dr **Provision for Taxation Account** Cr

Particulars	`	**Particulars**	`
To Cash (Tax paid previous year taxation) Balancing fig.	17,000	By Balance B/d	16,000
To Balance B/d	18,000	By (Adjusted profit & Loss A/c) provision for taxation made during the year	19,000
	35,000		**35,000**

Notes

The next step is to prepare the Adjusted profit and loss account.

Adjusted Profit & Loss Account

Particulars	`	Particulars	`
To Depreciation Building	4,000	By Balance B/d	16,000
To Depreciation Plant	4,000	By Fund from operations	36,000
To Transfer to General Reserve	4,000		
To Provision for taxation	19,000		
To Interim dividend	8,000		
To Balance c/d	13,000		
	52,000		**52,000**

The next step is to prepare the fund flow statement.

Fund Flow Statement

Sources	`	Applications	`
Fund from operations	36,000	Purchase of the plant	3,000
		Purchase of the Investment	1,000
		Increase in working capital	7,000
		Tax paid	17,000
		Interim dividend	8,000
	36,000		**36,000**

The following are the summarized balance sheets of PTC Ltd., as on 31st March 2009 and 2010:

Balance Sheet 2009

Liabilities	`	Assets	`
Share capital	9,00,000	Fixed Assets	8,00,000
General Reserve	6,00,000	Investments	1,00,000
Profit & Loss A/c	1,12,000	Stock	4,80,000
Sundry creditors	3,36,000	Sundry Debtors	4,20,000
Provision for taxation	1,50,000	Bank	2,98,000
	20,98,000		**20,98,000**

Balance Sheet 2010

Liabilities	`	Assets	`
Share capital	9,00,000	Fixed Assets	6,40,000
General Reserve	6,20,000	Investments	1,20,000
Profit & Loss A/c	1,36,000	Stock	4,20,000
Mortgage Loan	5,40,000	Sundry Debtors	9,10,000
Sundry creditors	2,68,000	Bank	3,94,000
Provision for taxation	20,000		
	24,84,000		**24,84,000**

Additional Information:

□Ā Ā Ā Ā
nvestments costing `16,000 were sold during the year for `17,000 and further investments purchased during the year for `36,000.

□Ā Ā Ā Ā
he net profit for the year was `1,24,000 after charging depreciation on fixed assets of `1,40,000 for the year and provision for taxation `20,000.

Notes

(iii) During the year, part of fixed assets costing `20,000 was disposed for `24,000 and the profit is included in the profit and loss account.

(iv) Dividend paid during the year amounted to ` 80,000.

The following are the components to be considered for preparation of the statement of changes working capital:

Current Assets:

Stock

Debtors

Bank

Current Liability:

Sundry creditors

The first step is to prepare the schedule of changes in the working capital.

Statement of changes in Working Capital

	2009 `	2010 `	Increase in Working Capital	Decrease in Working Capital
Current Assets:				
Stock	4,80,000	4,20,000		60,000
Debtors	4,20,000	9,10,000	4,90,000	
Bank	2,98,000	3,94,000	96,000	
	11,98,000	17,24,000		
Current Liability:				
Sundry creditors	3,36,000	2,68,000	68,000	
Working capital	8,62,000	14,56,000	6,54,000	60,000
Increase in working capital	5,94,000			5,94,000
	14,56,000	14,56,000	6,54,000	6,54,000

The next step is to prepare the non-current accounts.

At first, the non-current asset account is to be prepared.

The first non-current asset account is fixed assets account.

In the additional information, the firm has sold the fixed assets worth `10,000 at `12,000.

The next step is to determine the worth of the sale transaction of the fixed assets.

Sale value of the fixed assets	`24,000
Cost of the fixed assets sold	`20,000
Profit on the sale of fixed assets	`4,000

The following is the journal entries

Entry for sale of the asset

During the sale, what happens in the firm

Debit - What comes in? Cash resources are coming inside.

Notes

Credit-What goes out? Sold fixed asset is going out of the firm.

Cash A/c Dr `24,000

To Fixed Assets A/c `24,000

Entry for Profit on the sale of the transaction:

Fixed Assets A/c Dr ` 4,000

To Profit on sale A/c ` 4,000

In the next step, the earned profit during the sale of the fixed asset should be transferred to the Profit & Loss a/c

Profit on sale of the Fixed Assets A/c ` 4,000

To Profit & Loss A/c ` 4,000

Dr **Fixed assets account** Cr

Particulars	`	**Particulars**	`
To Balance B/d	8,00,000	By Cash (Sale)	24,000
To Profit on sale	4,000	By Adjusted Profit & Loss A/c(Depreciation)	1,40,000
		By Balance c/d	6,40,000
	8,04,000		**8,04,000**

The next non-current asset account is Investment account.

The purchase of the investment has taken place in the firm.

Investment A/c Dr `20,000

To Cash A/c `20,000

The worth of the sale of the transaction of the investment:

Sale value of the investment `,17,000

Cost of the investment `16,000

Profit of the sale of the investment `1,000

The profit on sale of the investment should be transferred to Profit & Loss account.

Profit on sale of the investment A/c `1,000

To Profit & Loss A/c `1,000

Then, the transferred profit on sale of investment should be deducted for the computation of fund from the operations, for which it should be appropriately effected in the Adjusted Profit & Loss Account.

Dr **Investment Account** Cr

Particulars	`	**Particulars**	`
To Balance B/d	1,00,000	By cash (sale)	17,000
To (profit on sale)Adjusted Profit &Loss A/c	1,000	By Balance c/d	1,20,000
To Cash(Purchase) Balancing fig.	36,000		
	1,37,000		**1,37,000**

Notes

The next non-current liability account is General Reserve account.

The opening balance is less than the closing balance of the general reserve account, which means that some portion of the current year profit is transferred to General Reserve. The actual entry is as follows:

Net profit A/c Dr `20,000

To General Reserve A/c `20,000

For finding out the fund from operations, the amount that was transferred from the net profit to general reserve should be added back in order to identify the original volume.

Adjusted Profit & Loss A/c `20,000

To General Reserve A/c `20,000

Dr **General Reserve A/c** Cr

Particulars	`	**Particulars**	`
		By Balance B/d	6,00,000
To Balance C/d	6,20,000	By (Adjusted profit &Loss A/c)Profit transferred to general reserve	20,000
	6,20,000		**6,20,000**

The next non-current liability is the Mortgage A/c.

The raising of mortgage loan leads to incoming of cash resources as well as further building up of the liabilities.

Debit what comes in - Cash resources are coming in.

Credit all liabilities - Mortgage loan is a liability/responsibility of the firm to repay it to the lender.

Cash A/c Dr `5,40,000

To Mortgage loan A/c `5,40,000

Dr **Mortgage A/c** Cr

Particulars	`	**Particulars**	`
To Balance C/d		By Balance B/d	----------
	5,40,000	By Cash(New Mortgage Loan) Balancing fig.	5,40,000
	5,40,000		**5,40,000**

The next important non-current liability is provision for taxation.

Dr **Provision for Taxation** Cr

Particulars	`	**Particulars**	`
To Cash (Tax paid previous year taxation)	1,50,000	By Balance B/d	1,50,000
To Balance C/d	20,000	By (Adjusted Profit & Loss A/c) Provision made during the current year	20,000
	1,70,000		**1,70,000**

Notes

The next step is to prepare the Adjusted Profit & Loss account.

Adjusted Profit & Loss Account

Particulars	`	Particulars	`
To Fixed Assets Depreciation	1,40,000	By Balance B/d	1,12,000
To Transfer of profit to general reserve	20,000	By Profit on sale of fixed assets	4,000
To Provision for taxation made during the current year	20,000	By Profit on sale of Investments	1,000
To Dividend paid	80,000		
To Balance c/d	1,36,000	By Fund from operations	2,79,000
	3,96,000		**3,96,000**

The next step is to prepare the fund flow statement.

Fund Flow Statement

Sources	`	Applications	`
Sale of fixed assets	24,000	Purchase of Investments	36,000
Sale of investments	17,000	Payment of previous year taxation	1,50,000
Mortgage loan raised	5,40,000	Payment of dividend	80,000
Fund from operations	2,79,000	Increase in working capital	5,94,000
	8,60,000		**8,60,000**

Self Assessment

Choose the appropriate answer

The meaning of the "To cash (Tax paid)" entry posted in the Provision for taxation account is

Last year taxation is paid through the current year provision

Current year taxation is paid through the current year provision

Last year tax is paid through the last year taxation

Current year taxation is paid through the last year provision

Profit on sale of the fixed assets are considered to be

Resource to the enterprise

Non-operating income

Application of the enterprise

None of the above

The treatment of current year depreciation with the closing balance of profit in determining the fund from operations

To be added

To be multiplied

To be deducted

To be divided

13. The redemption bank term loan leads to change in the

    Non-current liability account and current asset account

    Current asset account and current liabilities account

    Non-current asset account and current liabilities account

    Non-current asset account and current liabilities account

Flow of funds means the change in

(a) funds (b) working capital

(c) either (d) both

Which of the following is not an objectives fund-flow analysis?

It pinpoints the mobilization of resources and the further utilization of resources

It highlights the financing of the general expansion of the business firms

It exemplifies the utilization of debt finance in the structure of financing

None of these.

Which of the following is not a source of fund?

Purchase of Long-term Investments

Acceptance of deposits

Sale of Non-current Assets

Decrease in Working Capital

5.5 Summary

Fund flow statements summarize a firm's inflow and outflow of funds.

Simply put, it tells investors where funds have come from and where funds have gone.

The statements are often used to determine whether companies efficiently source and utilize funds available to them.

Fund flow statements are prepared by taking the balance sheets for two dates representing the coverage period.

The increases and decreases must then be calculated for each item. Finally, the changes are classified under four categories: (1) Long-term sources, (2) Long-term uses, (3) Short-term sources and (4) Short-term uses.

It is also important to zero out the non-fund based adjustments in order to capture only the changes that are accompanies by flow of funds.

However, income accrued but received and expenses incurred but not received reckoned in the profit and loss statement should not be excluded from the profit figure for the fund flow statement.

Fund flow statements can be used to identify a variety of problems in the way a company operates.

Meanwhile, a company that is using long-term money to finance short-term investments may not be efficiently utilizing its capital.

Notes

5.6 Keywords

Current Assets: Assets which are in the form of cash, equivalent to cash or easily convertible into cash.

Current Liabilities: Short-term financial resources of the firm.

Decrease in Working Capital: Decrease in Net working capital i.e. Excess of current liabilities over the current assets - Resources side of the fund flow.

Flow: Flow means changes occurred in between two different time periods.

Fund from Operations: Income generated from only operations.

Fund Lost in Operations: Loss incurred in the operations.

Fund: Fund means working capital

Increase in Working Capital: Increase in Net working capital i.e. Excess of current assets over the current liabilities- Applications side of the fund flow.

Non-current Assets: Long-term assets.

Non-current Liabilities: Long-term financial resources.

Statement of changes in Working Capital: Enlisting the changes taken place in between the current assets and current liabilities of two different time horizons.

5.7 Review Questions

From the following two balance sheet as at December 31, 2004 and 2005. Prepare the statement of sources and uses of funds.

	2004 (`)	**2005 (`)**	**2004 (`)**	**2005 (`)**
Liabilities				
Share capital	80,000	90,000		
Trade creditors	20,000	46,000		
Profit & Loss a/c	4,60,000	5,00,000		
Assets				
Cash			60,000	94,000
Debtors			2,40,000	2,30,000
Stock in trade			1,60,000	1,80,000
Land			1,00,000	1,32,000
	5,60,000	**6,36,000**	**5,60,000**	**6,36,000**

From the following balance sheets of XYZ Co. Ltd. Prepare Funds Flow Statement.

(` '000)

Liabilities	**2006**	**2007**	**Assets**	**2006**	**2007**
Equity share capital	600	800	Goodwill	230	180
Preference capital	300	200	Land and buildings	400	340
General reserve	80	140	Plant and machinery	160	400
Profit & Loss account	60	96	Debtors	320	400
Proposed dividend	84	10	Stock	154	218
Creditors	110	166	Bills receivable	40	60

Contd...

Notes

Bills payable	40	62	Cash	30	20
Tax provision	80	100	Bank	20	16
	1,354	**1,634**		**1,354**	**1,634**

Additional Information:

Proposed dividend made during 2006 has been paid during 2007.

Depreciation: (i) ` 20,000 on plant and machinery, and (ii) ` 40,000 on land and buildings.

Interim dividend has been paid ` 40,000 in 2007.

Income-tax ` 70,000 has been paid during 2007.

Discuss the various methods of determining the fund from/lost (in) operations.

Explain the process of preparing the statement of changes in working capital.

Draft the pro forma of the Fund Flow Statement.

The summarised balance sheets of KSBS Products for the years ended 31-03-2006 and 31-03-2007 are given below:

(` '000)

Capital and Liabilities	31.3.2006	31.3.2007	Assets	31.3.2006	31.3.2007
Share capital	500	500	Land and buildings	180	200
General reserve	200	220	Plant and machinery	210	276
Profit & Loss account	40	32	Other fixed assets	30	45
Bank loan (long-term)	-	100	Investments	50	50
Creditors	158	172	Stock	200	190
Provision for taxation	45	30	Debtors	170	195
			Cash at bank	103	98
	943	**1,054**		**943**	**1,054**

Prepare a statement of sources and application of funds given the following additional information relating to the year ended 31-3-2007.

Dividend amounting to ` 30,000 was paid during the year.

Provision for taxation made ` 12,000.

Machinery worth ` 15,000 (book value) was sold at a loss of ` 3,000.

Investment costing ` 10,000 was sold for ` 12,000.

Depreciation provided on assets: Land and buildings ` 5,000, Plant and machinery ` 20,00,000.

Prepare schedule of changes in Working Capital and Funds Flow Statement from the following Balance Sheets as on December 31, 2008.

Liabilities	2008	2009	Assets	2008	2009
	(`)	(`)		(`)	(`)
Capital	10,000	10,000	Cash	5,600	5,400
Profit & Loss A/c	5,200	15,400	Debtors	3,400	6,600
Long-term Loan	6,000	8,000	Stock	5,400	9,200
Short-term Loan	2,400	2,400	Long-term Investments	7,000	12,000

Contd...

Notes

Creditors	3,600	3,600	Plant	10,600	9,600
Outstanding Wages	1,400	800	Prepaid Insurance	400	800
Income Tax Provision	3,800	3,400			
	32,400	**43,600**		**32,400**	**43,600**

Plant was sold at its book value, i.e., ` 1,000

From the following Balance Sheets, prepare a Schedule of changes in Working Capital and Funds Flow Statement:

Liabilities	31.12.07	31.12.08	Assets	31.1 2.07	31.12.08
	(`)	(`)		(`)	(`)
Capital	4,80,000	5,10,000	Cash at Bank	24,000	54,000
Profit & Loss a/c	8,50,000	10,50,000	Debtors	9,90,000	11,90,000
Creditors	54,000	30,000	Stock	54,000	42,000
Mortgage Loans	28,000	1,00,000	Land	2,00,000	2,00,000
			Plant	1,44,000	2,04,000
	14,12,000	**16,90,000**		**14,12,000**	**16,90,00**

The following is the abstract of balance sheet of Software securities Ltd. for the year 2005 and 2006

	2005	2006		2005	2006
Liabilities	**(`)**	**(`)**	**Assets**	**(`)**	**(`)**
Provision for depreciation	108000	396000	Land	26000	81000
Retained earning	244800	370800	Building	60000	360000
9% Debenture	270000	198000	Accumulated depreciation on building	19800	37800
Account payable	72000	41400	Equipment	122400	347400
Expense payable	0	18000	Accumulated depreciation on Equipment	18000	50400
			Stock in hand	10800	97200
			Account receivable	36000	122400
			Cash in hand	66600	97200
			Preliminary expenses	10800	7200

The income statement of Software Securities Ltd. is as under

Sales	1602000
less cost of sale	837000
less operating exp.	397800
less interest exp.	21600
loss on sale of equipments	3600
	126000
Net income before tax	342000
Provision of tax	117000
Net Income after tax	225000

Notes

Additional Information:

Operating expenses include depreciation of ` 59400 and charges from preliminary expenses of ` 3600.

Land was sold at its book value.

Cash dividend paid for the year 2006 amounted to ` 27000 and fully paid bonus shares were given in the ratio of 2 shares for every 3 shares hel(d).

Interest expenses was paid in cash.

Equipment with a cost of ` 298800 was purchased for cash. Equipment with a cost of ` 73800 (book value ` 64800) was sold for ` 61200.

Debenture for ` 18000 were redeemed for cash and for ` 54000 were redeemed by converting into equity shares at par value.

Equity shares of ` 162000 were issued for cash at par.

Income tax paid during the year amounted to ` 117000.

Prepare the fund flow statement with both the methods.

"Fund flow statements can be used to identify a variety of problems in the way a company operates." Illustrate the statement by the help of suitable examples.

Answers: Self Assessment

1.	cash	2.	Working capital change
3.	False	4.	True
5.	False	6.	False
7.	(c)	8.	(a)
9.	(a)	10.	(a)
11.	(b)	12.	(a)
13.	(a)	14.	(d)
15.	(d)	16.	(a)

5.8 Further Readings

Books

B.M. Lall Nigam and I.C. Jain, *Cost Accounting*, Prentice-Hall of India (P) Ltd.

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