Fund Flow and Cash Flow Analysis

Definition of Fund Flow Statement

Fund flow statement is a statement which shows the sources from which funds are obtained and uses to which funds are put in an accounting cycle. Fund flow statement is a technical device to explain how the working capital position of an enterprise changes over a period of time generally covering- two balance sheet dates (i.e., between the opening and closing dates of the Balance Sheet). It reveals the amount of fund generated by the firm internally along with the amount of funds raised from various external sources and their various uses during the year. By depicting, all inflows and outflows of fund, the statement shows their net impact on working capital of the firm. If the total of inflows is greater than total of outflows, the excess goes to enhance the working capital. If it is otherwise, the working capital is impaired. It is also called the Statement of Sources and Applications of Funds, Movement of Funds Statement, Where Got-Where Gone Statement and Inflow and Outflow of Fund Statement etc.

Objective of Preparing a Fund Flow Statement

1. It reveals how much out of the total funds is being collected by disposing of fixed assets, how much from issuing shares or debentures, how much from long-term or short-term loans and how much from normal operational activities of the business.

2. It also provides the information about the specific utilisation of such funds, how much has been applied for acquiring fixed assets, how much for repayment of long-term or short-term loans as well as for payment of tax and dividend etc.

Limitations of Fund Flow Statement:

1. A projected funds flow statement does not always present much accurate estimates about the financial position since it is a historic one.

2. The fund flow statement is prepared by re-arranging the figures already provided in the balance sheet and income statement. So it is not a basic financial statement or not a original statement, rather it is a supplementary statement. It does not disclose any new item which is not reflected in the balance sheet.

Differences between Fund Flow Statement and Income Statement:

Fund Flow Statement	Income Statement
A fund flow statement deals with the financial resources required for running the business activities. It shows how the funds were obtained and how they were used.	An income statement shows the results of the business activities i.e., how much has been earned and how much has been spent.
Fund flow statement incorporates both capital and revenue transactions. It maintains records from all sources of funds irrespective of capital and revenue.	Capital receipts and capital payments are not considered in income statement. It comprises of only revenue items.
It is complementary to income statement. It takes help from Income Statement.	Income statement does not depend on fund flow statement.
The items in fund flow statement are mostly shown at current prices. So the statement is not affected by change in price level.	Income Statement is prepared on the basis of historical prices. So profit as revealed is vitiated due to change in price level.
There is no specific format for preparing a funds flow statement.	Income statement is prepared on the basis of prescribed format.
It helps the management to take decisions relating to finance.	It cannot help in decision making.
It is not mandatory.	It is compulsory.
Besides funds from operations, sources of funds are many such as issue of share capital and debentures, sale of fixed assets, etc.	An income statement shows the results of operations. It cannot give accurately the funds from operations because of non-fund items such as writing of depreciation, fictitious assets, etc. being included therein.
It does not recognise non-cash items i.e. exclude non-cash items.	It includes all non-cash incomes and non-cash expenses.
Fund flow statement is more reliable as many items shown here are not generally subject to manipulation.	Many items in the income statement such as depreciation, writing off intangibles etc. can be manipulated by the management.

Both income statement and funds flow statement perform different functions. One cannot be a substitute for the other; rather they are complimentary to each other. Modern management needs both.

Preparation of Fund Flow Statement:

Mainly two comparative balance sheets at the beginning and end of a period are used for preparing a funds flow statement. The funds flow analysis involves the preparation of the following, viz. (a) Statement or schedule of changes in working capital, (b) Necessary ledger accounts for non-current assets and non-current liabilities and (c) Sources and uses of funds statement.

Sources and Uses of Fund

Various sources from which funds are obtained and possible applications or uses of such funds are as follows:

Sources (Inflows)	Amount (Rs.)	Applications (Outflows)	Amount (Rs.)
Fund from Operation			
Issue of Equity and Preference Share Capital		Redemption of Preference Shares	
		Redemption of Debentures	
Issue of Debentures		Buy-back of Equity Shares	
Long Term Loan taken		Repayments of Loan	
Sale of Fixed Assets		Purchase of Fixed Assets	
Sale of Investments		Purchase of Investments	
Non-trading Incomes like Dividend Rent, etc.		Payment of Dividends	
		Payment of Interest	
Decrease in Working Capital		Payment of Tax	
		Payment of Hire Purchase Instalments	
		Increase in Working Capital	

Statement of Changes in Working Capital

The purpose of this statement is to find out the net change in working capital. The format of the statement is as follows:

Statement showing changes in Working Capital

Previous year (Rs.) **Current year (Rs.)**

A. Current Assets:

Cash balance

Bank balance

Bills receivable

Debtors

Marketable Securities

Closing stock

Prepaid expenses

Accrued incomes

Total (A)

B. Current liabilities:

Bank overdraft

Bills payables

Creditors

Outstanding expenses

Pre-received incomes

Total (B)

Total (A)> Total (B) =Net increase in working capital

Total (A)< Total (B) =Net decrease in working capital

Example:

From the following balance sheet of Suraj Ltd prepare a Fund flow statement.

Liabilities	2007 Rs.	2008 Rs.	Assets	2007 Rs.	2008 Rs.
Equity share	1,50,000	2,00,000	Goodwill	50,000	40,000
8% Redeemable preference capital	75,000	50,000	Land	1,00,000	85,000
Capital reserve	5,000	10,000	Plant	40,000	1,00,000
General reserve	15,000	25,000	Investment	10,000	15,000
P & L a/c	15,000	24,000	Debtors	70,000	85,000
Proposed dividend	21,000	25,000	Bills	10,000	15,000
Creditors	12,500	23,500	Cash in hand	7,500	5,000
Liability for	15,000	18,000	Bank	5,000	4,000
Bills payable	10,000	8,000	Stock	38,600	54,500
Provision for	20,000	25,000	Preliminary	7,500	5,000
	3,38,500	4,08,500		3,38,500	4,08,500

Additional Information

a) A piece of land had been sold out in 1997 and the profit on sale has been credited to capital reserve.

b) A plant has been sold for Rs.5,000. The written down value of the plant was Rs.6,000 depreciation on plant is charged at 10% for 2008.

c) The investments are trade investments Rs.1500 by way of dividend is received including Rs.500 from pre-acquisition profit which has been credited to investment account.

d) An interim dividend of Rs.10,000 has been paid in 2008.

e) Income tax paid during 2008 is amounted to Rs.15,000.

f) 8% Redeemable preference capital were redeemed at 10% discount.

Solution:

Statement showing changes in Working Capital

	2007 Rs.	2008 Rs.
Current Assets		
Debtors	70,000	85,000
Stock	38,000	54,500
Bills Receivable	10,000	15,000
Cash	7,500	5,000
Bank	5,000	4,000
Total (A)	1,31,000	1,63,500
Current liabilities		
Creditors	12,500	23,500
Bills Payable	10,000	8,000
Liability for exp	15,000	18,000
Total (B)	37,500	49,500
Working capital (A)-(B)	93,500	1,14,000
+ Working capital	20,500	
	1,14,000	

Goodwill A/c

Particulars	**Rs.**	**Particulars**	**Rs.**
To bal b/d	50,000	By P&L a/c-written off (Bal)	10,000
		By bal c/d	40,000
	1,05,000		50,000

Land A/c

Particulars	**Rs.**	**Particulars**	**Rs.**
To bal b/d	1,00,000	By Cash-sales (Bal)	20,000
To Capital Reserve	5,000	By bal c/d	85,000
	1,05,000		1,05,000

Plant A/c

Particulars	**Rs.**	**Particulars**	**Rs.**
To bal b/d	40,000	By Cash-sales	5,000
To Cash-purchase(Bal)	71,000	By P&L a/c- Loss on sales	1,000
		By P&L a/c-Dep.	5,000
		By bal c/d	1,00,000
	1,11,000		1,11,000

Investment A/c

Particulars	**Rs.**	**Particulars**	**Rs.**

To bal b/d	10,000	By Dividend Received	500
To Cash-Purchase(Bal)	5,500	By bal c/d	15,000
	15,500		15,500

Preliminary Exp. A/c

Particulars	Rs.	Particulars	Rs.
To bal b/d	7,500	By P&L a/c-written off (Bal)	2,500
		By bal c/d	5,000
	7,500		7,500

Equity share capital A/c

Particulars	Rs.	Particulars	Rs.
		By bal b/d	1,50,000
To bal c/d	2,00,000	By Bank-issue of capital (Bal)	50,000
	2,00,000		2,00,000

8% Red. Pref. share capital A/c

Particulars	Rs.	Particulars	Rs.
To Bank-redemption of capital	22,500	By bal b/d	75,000
To P&L a/c-discount (Bal)	2,500		
To bal c/d	50,000		
	75,000		75,000

Capital Reserve A/c

Particulars	Rs.	Particulars	Rs.
		By bal b/d	5,000
To bal c/d	10,000	By Land	5,000
	10,000		10,000

General Reserve A/c

Particulars	Rs.	Particulars	Rs.
		By bal b/d	15,000
To bal c/d	25,000	By P&L a/c-transfer (Bal)	10,000
	25,000		25,000

Proposed Dividend A/c

Particulars	Rs.	Particulars	Rs.
To Bank-proposed dividend paid	21,000	By bal b/d	21,000
To bal c/d	25,000	By P&L a/c-transfer (Bal)	25,000
	46,000		46,000

Provision for taxation A/c

Particulars	Rs.	Particulars	Rs.
To Bank-tax paid	15,000	By bal b/d	20,000
To bal c/d	25,000	By P&L a/c-provision (Bal)	20,000
	40,000		40,000

Adjusted P &L A/c

Particulars	Rs.	Particulars	Rs.
To plant- depreciation	5,000	By bal b/d	15,000
To plant-loss on sale of Plant	1,000	By dividend (1,500 – 500)	1,000
To Provision for tax	20,000	By 8% Red. Pref. share capital	2,500
To General Reserve	10,000	By Funds from operation (Bal)	89,000
To Goodwill-written off	10,000		
To Prel. Exp.-written off	2,500		
To Proposed dividend	25,000		
To Interim dividend	10,000		
To bal c/d	24,000		
	1,07,500		1,07,500

Fund Flow Statement

Sources	Rs.	Application	Rs.
Funds from operation	89,000	Redemption of preference share	22,500
Issue of equity shares	50,000	Purchase of plant	71,000
Sale of land	20,000	Purchase of Investment	5,500
Sale of plant	5,000	Payment of Tax	15,000
Dividend received	1,500	Payment of proposed dividend	21,000
		Payment of Interim dividend	10,000
		Increase in working capital	20,500
	1,65,500		1,65,500

Definition of Cash Flow Statement

The cash flow statement is a statement which reveals the causes leading to change in cash balance between dates of two balance sheets of the firm. It provides information regarding amount of cash generated from different sources, their different uses and ultimately net impact on cash balance during the period. Thus, it is a statement which explains where cash came from during a period and where it was spent and thereby gives an idea about changes in cash balance.

Features and objectives of Cash Flow Statement

1. This statement is generally prepared for a year, hence it is periodical in nature.

2. This statement is also dynamic as it shows movement of cash and causes of changes in cash balance from the beginning balance sheet up to the date of next balance sheet.

3. It classifies activities affecting cash as operating activities, investing activities and financing activities.

Differences between Cash Flow & Fund Flow Statement:

Cash Flow Statement	Fund Flow Statement
Cash flow statement takes in to consideration only the changes in cash position between two balance sheets	Fund flow statement is concerned with changes in working capital position between two balance sheet dates
The cash flow statement is based on cash basis of accounting, since actual amount of cash receipts and payments are incorporated.	Fund flow statement is based on accrual basis of accounting, since it deals with the preparation of Adjusted P&L a/c.
Cash flow analysis is a tool of short-term and long-term financial analysis.	Fund flow analysis is used for intermediate and long-term financial planning.
Cash flow statement is prepared by taking the opening balance of cash and bank and closes with the closing balance of cash and bank.	Funds flow statement tallies the funds generated from various sources with the various which they are put.
According to AS-3, Cash flows are classified into: (a) Operating activities, (b) Investing activities, and (c) Financing activities.	Funds flow statement is not classified like cash flow statement.
Cash flow statement is not so informative like fund flow statement since it informs only the cash position.	Funds flow statement is much more informative since it informs about the fund.
It has also got very useful role in signalling corporate sickness.	It cannot give signal to corporate sickness effectively.
It is used for cash generating capacity of a firm.	It is used for funds generating capacity of a firm.

Differences between Cash Flow Statement and Cash Book:

Cash Book	Cash Flow Statement
Cash Book is prepared with the objective of recording cash receipts and cash payments only.	It shows the various activities relating to inflow and outflow of cash in the form of operating, investing and financing activities at the end of the period.

Cash Book is prepared to know the cash balance at the end of a particular period of a firm.	Cash flow statement is prepared to know the cash generating capacity of a firm.
Day to day cash transactions are recorded in the cash book.	Cash Flow Statement is prepared at the end of the accounting period.
To maintain a cash book, preliminary knowledge in accounting is enough.	To maintain a cash flow statement, sound knowledge in accounting is required.
It does not help in managerial or financial decision-making.	It helps in managerial or financial decision-making.
It cannot highlight the liquidity and profitability position of a firm.	It throws some light on the liquidity and profitability position of a firm.

Differences between Cash Budget and Cash Flow Statement:

Cash Budget	Cash Flow Statement
Cash budget is futuristic; it reflects expected receipts and payments of cash under different heads during the budget period.	Cash flow statement is historic, as it is a post mortem analysis of cash inflows and outflows during a past period.
The objectives of cash budget is to point out whether there will be any deficiency or surplus of cash in course of executing planned activities and thereby to draw attention to the need of arranging additional cash or investing the surplus cash elsewhere.	The purpose of cash flow statement is to indicate how the cash position of the firm has undergone change from start of a period up to the last part of the period.
Cash budget can be prepared for a short period or even for a longer period. It can be monthly, weekly, or even daily and also again, half yearly, yearly. However in general practice it is broken into month.	Cash flow statement is usually prepared for one accounting year.
Cash budget is prepared based on various functional budgets.	Cash flow statement is prepared based on the opening and closing balance sheet, Adjusted Profit and Loss account and some other additional information.

Limitations of Cash Flow Statement:

Cash flow statement has got certain inadequacies which are as follows:

Incompetent to disclose actual profitability: As cash flow statement does not consider non-cash items, it cannot tell the actual profit earned by the company.

Historical in nature: Cash flow statements are based on historical information and hence do not provide complete information for assessing future cash flows.

Cash Flow Statements (AS-3)

The original AS-3, issued in June 1981 was titled "Changes in Financial Position." The Council of the Institute of Chartered Accountants of India revised and issued AS-3 with the title "Cash Flow Statements" in March, 1997.The revised and new AS-3 outdated the original AS-3 of 1981.

Objective of the revised standard: AS 3 revised in 1997 has recommended revised Cash Flow Statement [CFS] for listed companies and other industrial, commercial, and business undertakings in the private and public sector. It is at present recommendatory in character. According to revised AS 3, CFS should be prepared in such a way as to report the cash flows during the period separately for operating, investing and financing activities.

The following terms should be understood and remembered:

Cash: It consists of cash on hand and demand deposits made with banks.

Cash equivalents: These mean short-term and highly liquid investments which may be readily converted to cash of known amounts and which are subject to an insignificant risk regarding changes in value. These are held mainly to meet short-term cash commitments. An investment may be considered as a cash equivalent only where it has a short maturity period.

Cash flows: These mean inflows and outflows of cash.

Operating activities: The examples are as follows: Cash receipts from sale of goods and services, Cash payments to suppliers of goods and services, Cash payments to employees, Cash receipts from royalties, fees, commission, and other revenue, Payment and refund of income tax, In the case of insurance companies, cash receipts and payments for premium received and claims and other benefits to policy holders.

Investing activities: Examples of such activities are as follows: Cash receipts from sale of fixed assets including intangibles, Purchase of fixed assets including intangibles and payments relating to capitalized and development cost and self-constructed fixed assets, Purchase of securities for cash such as shares, warrants, and debt instruments of other enterprises, Purchase and sale of investments.

Financing activities: Examples of such activities are as follows: Cash receipts from the issue of shares and other similar instruments, Cash receipts from the issue of debentures, bonds, long or other short-term, Redemption of shares and repayment of amounts borrowed.

Cash Flow Statement (Under Indirect Method), AS-3

Particulars	Amount Rs.	Amount Rs.
1. Cash Flows from Operating Activities		
Cash generated from operation (figure is obtained by preparing Adjusted P&L a/c)		
(+)Increase in Current Liabilities		
(+)Decrease in Current Assets		
(-)Increase in Current Assets		
(-)Decrease in Current Liabilities		
Less: Direct Tax Paid (including Advance Tax)		
Interest Paid		
Net Cash arising from Operating Activities		
2. Cash Flows from Investing Activities		
Sale Proceeds of Fixed Assets and investments		
(-)Purchase of Fixed Assets and Investments		
(+)Dividends Received		
(+)Interests Received		
Net Cash from Investing Activities		
3. Cash Flows from Financing Activities		
Issue of Equity, Preference share and debenture		
(including premium but excluding discount)		
(-)Redemption of Preference Share and Debenture		
(-)Buy back of equity shares		

Long term debt raised

(-)Repayment of other long term debt

Loan raised

(-) Loan paid

(-)Payment of dividend (Interim & Final)

Net Cash from Financing Activities

Net changes of cash (1+2+3)

(+)Cash and Cash equivalents at the beginning of the period

Cash and Cash equivalents at the end of the period

Example:

The following are the summarised balance sheets of Mekhala Ltd. as on 31st December 2007 and 31st December 2008:

Liabilities	**2007 Rs.**	**2008 Rs.**	**Assets**	**2007 Rs.**	**2008 Rs.**
Share Capital	12,00,000	16,00,000	Plant & Machinery (at cost)	8,00,000	12,90,000
Debentures	4,00,000	6,00,000	Land & Building (at cost)	6,00,000	8,00,000
Profit & Loss A/c	2,50,000	5,00,000	Stock	6,00,000	7,00,000
Creditors	2,30,000	1,80,000	Debtors	1,38,000	1,22,000
Provision for Bad and doubtful debts	12,000	6,000	Bank	40,000	80,000
Depreciation on Land & Building	40,000	48,000	Preliminary expenses	14,000	12,000
Depreciation on Plant &Machinery	60,000	70,000			
	21,92,000	30,04,000		21,92,000	30,04,000

Additional Information:

1. During the year a part of machinery costing Rs. 1,40.000 (accumulated depreciation there on Rs.4,000) was sold for Rs.12,000.

2. Dividend for Rs. 1,00,000 was paid during the year.

Solution:

Plant & Machinery A/c

Particulars	Rs.	Particulars	Rs.
To bal b/d	8,00,000	By Bank-sale	12,000
To Bank - purchase (Bal)	6,30,000	By P&L a/c-Loss on sale	1,24,000
		By Provision for dep.-dep. transferred	4,000
		Balance c/d	12,90,000
			14,30,000

Provision for Depreciation on Plant & Machinery A/c

Particulars	Rs.	Particulars	Rs.
To Plant & Machinery	4,000	By Bal b/d	60,000
To Bal c/d	70,000	By P&L a/c (Bal)	14,000
	74,000		74,000

Land & Building A/c

Particulars	Rs.	Particulars	Rs.
To bal b/d	6,00,000		
To Bank - purchase (Bal)	2,00,000	By Bal c/d	8,00,000
	8,00,000		8,00,000

Provision for depreciation on Land & Building A/c

Particulars	Rs.	Particulars	Rs.
		By Bal b/d	40,000
To Bal c/d	48,000	By P&L a/c (Bal)	8,000
	48,000		48,000

Preliminary expenses A/c

Particulars	Rs.	Particulars	Rs.
To bal b/d	14,000	By P&L a/c (Bal)	2,000
		By Bal c/d	12,000
	14,000		14,000

Share Capital A/c

Particulars	Rs.	Particulars	Rs.
		By Bal b/d	12,00,000
To Bal c/d	16,00,000	By Bank-issue (Bal)	4,00,000
	16,00,000		16,00,000

Debentures A/c

Particulars	Rs.	Particulars	Rs.
		By Bal b/d	4,00,000
To Bal c/d	6,00,000	By Bank-issue (Bal)	2,00,000
	6,00,000		6,00,000

Dividend a/c……………….Dr 1,00,000
To Cash a/c 1,00,000
P&L a/c……………….Dr 1,00,000
To Dividend a/c 1,00,000

Adjusted Profit &Loss A/c

Particulars	Rs.	Particulars	Rs.
ToProvision for depreciation on:		By Bal b/d	2,50,000
Plant& Machinery	14,000	By Cash from operation (Bal)	4,98,000
Land & Building	8,000		
To Plant & Machinery	1,24,000		
To Preliminary expenses	2,000		
To Dividend	1,00,000		
To Bal c/d	5,00,000		
	7.48,000		7.48,000

Cash Flow statement under AS-3 of Mekhala Ltd.

1.Cash Flows from Operating Activities	Rs.	Rs.
Cash from operation	4,98,000	
(+) Decrease in Debtors	16,000	
(-) Increase in stock	1,00,000	
(-) Decrease in creditors	50,000	
(-) Decrease in Provision for Bad and doubtful debts	6,000	
Net cash from Operating Activities		3,58,000
2.Cash Flows from Investing Activities		
Sale of Plant & Machinery	12,000	
(-) Purchase of Plant & Machinery	6,30,000	

(-) Purchase of Land & Building	2,00,000	
Net cash used in Investing Activities		(8,18,000)
3.Cash Flows from Financing Activities		
Issue of equity shares	4,00,000	
Issue of debenture	2,00,000	
(-) Payment of dividend	1,00,000	
Net cash from Financing Activities		5,00,000
Net changes of cash (1+2+3)		40,000
(+)Cash and cash equivalent at the beginning of the year		40,000
Cash and cash equivalent at the end of the year		80,000