

The General Assembly of Al Madinah Company met in early **January 2021** to discuss the performance reports for the year 2020. The Financial Manager submitted a report that included the company's business results for the year 2020, and also included data for the year 2019. The following are the data on assets and liabilities as included in the report for the past two years:

Items	2019	2020
Assets:		
Cash	90000	95000
Financial Securities	-----	30000
Prepaid Expenses	10000	10000
Inventory	475000	550000
Land	15000	20000
Buildings	425000	395000
Accounts Receivable	370000	340000
Machinery & Equipment	510000	525000
Accumulated Depreciation	395000	430000
Liabilities & Equity:		
Capital	480000	460000
Retained Earnings	155000	195000
Accounts Payable	380000	400000
Notes Payable	15000	10000
Long term Loans	290000	290000

Required:

- 1- Prepare the company's sources of funds and uses statement.**
- 2- If you have the following data about the company's profitability position:**
 - Retained earnings in 2019 = 155,000 pounds
 - Realized profits in 2020 = 70,000 pounds
 - Available Distributable profits in 2020 = 225,000 pounds
 - Distributed profits for 2020 = 30,000 pounds
 - Retained profits for 2020 = 195,000 pounds .. **Is the statement different in this case?**
- 3- What are the most important uses of the sources of funds and uses statement?**
- 4- What are the most important results that can be drawn from the previous statement? And to what extent are these results accurate?**
- 5- Does the company apply the principle of matching or coverage in financing? What is the result of applying it or not applying it?**
- 6- Do you agree to consider depreciation as a source of funds? Why?**

The Answer

1 - sources and uses statement of the "Al-Madinah Al-Munawwarah" Company for the period from 2019 - 2020 (Value in thousand pounds)

Items	2019	2020	Change + (-)	Movement of funds	
				Use of source	
Assets:					
<u>Current assets</u>					
Cash	90	95	5	5	
A. Financial	---	30	30	30	
Prepaid expenses	10	10	--		
Inventory	475	550	75	75	
Accounts receivable	370	340	(30)		30
<u>Fixed assets</u>					
Land	15	20	5	5	
Buildings	425	395	(30)		30
Machinery & equipment	510	525	15	15	
Accumulated depreciation	395	430	35		35
Liabilities & equity					
<u>Short T. liabilities:</u>					
A. payable	380	400	20		20
N. Payable	15	10	(5)	5	
<u>Long T. Liabilities:</u>					
Long term Loans	290	290	--		
<u>Equity:</u>					
Capital	480	460	(20)	20	
Retained earnings	155	195	40		40
Total				155	155

Important note:

No matter financial data are included in the exercise about the company's profitability position, we only use **two** of them:

- Realized Profits in the last year, which will be listed under sources of funds.
- Distributed Profits (dividends) in the last year, which will be listed under uses.

2 - sources and uses statement of "Al-Madinah Al-Munawarah" Company for the period from 2019 - 2020

After taking into account the profitability position

Uses	Value in thousand pounds	Sources	Value in thousand pounds
Cash	5	A. Receivable	30
A. Financial	30	Buildings	30
Inventory	75	Accumulated depreciation	35
Land	5	Accounts payable	20
Machinery & equipment	15	Realized profits	70
A. Payment	5		
Capital	20		
Distributed profits (Dividends)	30		
Total uses	185	Total sources	185

The difference between the previous statement and the first statement is noted in:

- 1- The increase in both sources and uses from 155 thousand pounds to 185 thousand pounds.**
- 2- The last statement took into account the profitability position of the company, as the distributed profits are considered a use of funds and the realized profits are a source for them.**

4- The most important results that can be drawn from the previous list are:

A - Regarding the uses side: The company's funds, amounting to 185 thousand pounds, were used in the following:

- Increase cash by 5000 pounds.
- Increase securities by 30000 pounds.
- Increase inventory by 75000 pounds.
- Purchase of land by 5000 pounds.
- Purchase of machinery by 15000 pounds.
- Paying part of the Notes payable by 5000 pounds.
- Reducing capital by 20000 pounds.
- Distributing profits to shareholders by 30000 pounds.

B - Regarding the sources side: The company's financial needs amounted to 185 thousand pounds, which were financed from the following sources:

- Decrease in accounts receivable by 30000 pounds.
- Selling part of the buildings by 30000 pounds.
- Funds generated from operations (depreciation + realized profits) by 105000 pounds. (35 + 70).
- Increase accounts payable by 20,000 pounds.

5- In order to determine whether the company applies the principle of alignment or **coverage in financing** or not, we must link the components of the list of sources and uses to the time element, as follows:

Sources and uses statement of the “Al-Madinah Al-Munawwarah” company for the period from 2014-2015 after linking its components to the time element

Uses	Value in thousand pounds	Sources of funds	Value in thousand pounds
Cash	5	Accounts Receivable	30
Financial securities	30	Accounts Payable	20
Capital	75		
N. Payable	5		
Short term uses	115 (62%)	Short term Sources	50 (27%)
Land	5	Buildings	30
Buildings & Equipment	15	Accumulated depreciation	35
Capital	20	Realized profits	70
Distributed Dividends	30		
Long term uses	70 (38%)	Long term Sources	135 (73%)
Total uses	185 (100%)	Total Sources	185 (100%)

From the previous statement, we conclude that: The company suffers from a financial defect represented by its failure to apply the principle of alignment or coverage in financing, as it financed a large portion of short-term uses from long-term financing sources, equivalent to 65 thousand pounds, at a rate of 35%, and the result of this is: an increase in the company's liquidity at the expense of its profitability.

6 - I do not agree with considering depreciation as a source of funds, as:

First: Depreciation is an accounting entry that does not results in withholding part of the company's profits, so that if the asset's useful life has ended, the company may have enough money to replace this asset with another new asset.

Second: Some mistakenly believe that depreciation is a source of funds:

- When re-adding depreciation in order to reach the total profits generated from operations.
- Some may see depreciation as an indirect source of funds on the basis that it is considered a tax protection, but this logic necessarily applies to all expenses recorded on the basis of the accrual principle, and therefore this opinion is incorrect.

Third: The only case in which depreciation is considered a source of funds is the case of preferring the declining installment method over the fixed installment method, where the differences in cash outflows are considered an interest-free loan.