



BACHELOR OF COMPUTER APPLICATIONS

SEMESTER 4

DCA2204

PRINCIPLES OF FINANCIAL ACCOUNTING AND MANAGEMENT

Unit 10

Funds Flow Analysis

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1. INTRODUCTION

For the purpose of fund flow statement, the term fund means net working capital. The flow of fund will occur in a business, when a transaction results in a change i.e., increase or decrease in the amount of fund. It is a technical device designed to highlight the changes in the financial condition of a business enterprise between two balance sheets.

1.1 Objectives

After studying this unit you will be able to:

- ❖ *Explain the meaning of Fund Flow Statement.*
- ❖ *Explain the objectives of Fund Flow Statement.*
- ❖ *Compute Fund from Operations.*

2. MEANING OF FUND FLOW STATEMENT

Fund may be interpreted in various ways as (a) Cash, (b) Total current assets, (c) Net working capital, (d) Net current assets.

A fund flow statement **reveals the reasons for changes or anomalies in the financial position of a company between two balance sheets**. Fund flow statements portray the inflow and outflow of funds - or the sources and applications of funds over a particular period.

According to Robert Anthony, the Fund Flow Statement describes the sources from which additional funds were derived and the uses to which these funds were put.

Different Names of Fund-flow Statement

- ★ A Funds Statement
- ★ A statement of sources and uses of fund
- ★ A statement of sources and application of fund
- ★ Where got and where gone statement
- ★ Inflow and outflow of fund statement

3. OBJECTIVES OF FUND FLOW STATEMENT

The main purposes of Fund Flow Statement are:

1. To help to understand the changes in assets and asset sources which are not readily evident in the income statement or financial statement.
2. To inform as to how the loans to the business have been used.
3. To point out the financial strengths and weaknesses of the business.

Format of Fund Flow Statement

Sources

Applications

Fund from operation	– Fund lost in operations
Non-trading incomes	– Non-operating expenses
Issue of shares	– Redemption of redeemable preference share
Issue of debentures	– Redemption of debentures
Borrowing of loans	– Repayment of loans
Acceptance of deposits	– Repayment of deposits
Sale of fixed assets	– Purchase of fixed assets
Sale of Investments	– Purchase of long-term Instruments (Long Term)
Decrease in working capital	– Increase in working capital

4. STEPS IN PREPARATION OF FUND FLOW STATEMENT

1. Preparation of schedule changes in working capital (taking current items only).
2. Preparation of adjusted profit and loss account (to know fund from [or] fund lost in operations).
3. Preparation of accounts for non-current items (Ascertain the hidden information).
4. Preparation of the fund flow statement.

Format of Schedule of Changes in Working Capital

Particulars	Previous Year	Current year	Increase in W/c	Decrease in W/c
Current Assets				
Cash in hand				
Cash at bank				
Bills receivable				
Debtors				
Inventory				
Prepaid expenses				
Short-term investment				
(A) Total				
Current Liability				
Bills Payable				
Creditors				
Outstanding expenses				
Accrued expenses				
Income received in advance				
Bank overdraft				
Cash credit from banks				
Short-term loan				
Short-term deposit				
Provision for taxation				
Proposed dividend				
Provision against current assets				
(B) Total				
Working Capital (C)				
(C = A – B)				
Increase in W/C				
Decrease in W/C				

Fund from operation can be ascertained by preparing adjusted profit and loss account. It may be prepared in statement form or account form.

Format of Adjusted Profit and Loss Account

To Bal. B/d (P&L Account Dr. Bal.)	By Bal. B/d (P&L Account Cr. Bal.)
To Non-operating Exp.	By Non-operating Incomes
To Depreciation on Fixed Assets	By Profit on sale of Investment
To Goodwill written-off	By profit on sale of fixed asset
To Patent & trademark off	By Dividend on Investment
To Preliminary expenditure	By Interest on Investment
To Discount on issue of shares &	By Rent received, gift received Debentures
To Loss on sale of investment	By Damages received under law
To Loss on sale of Fixed Assets	By Transfer from general reserve
To damages paid under law	
To Premium on redemption of profit Share and debentures	
To Interim dividend To Dividend declared	
(A) Total	

To ascertain the hidden information, we have to prepare accounts for all non-current items of assets and liabilities (whether adjustment is given or not) then only easier to find the inflow and outflow of funds.

SELF-ASSESSMENT QUESTIONS -1

1. The term fund means _____
2. The flow of fund will occur in a business, when a transaction results in _____
3. According to _____ the Fund Flow Statement describes the sources from which additional funds were derived and the uses to which these funds were put.
4. The main purposes of Fund Flow Statement are:
 - A) To help to understand the changes in assets and asset sources which are not readily evident in the income statement or financial statement.
 - B) To inform as to how the loans to the business have been used.
 - C) To point out the financial strengths and weaknesses of the business.
 - D) All the above



5. COMPUTATION OF CHANGES IN WORKING CAPITAL AND FUND FROM OPERATIONS

Illustration 1

From the following balance sheets of Mr. M. prepare the statement of schedule of changes in working capital.

Balance Sheet as at December 31

Liabilities	2005	2006	Assets	2005	2006
Equity Capital	5,00,000	5,00,000	F. assets	6,00,000	7,00,000
Debentures	3,70,000	4,50,000	Long-term Investment	2,00,000	1,00,000
Tax payable	77,000	43,000	Working progress	80,000	90,000
Accounts Payable	96,000	1,92,000	Stock-in-trade	1,50,000	2,25,000
Interest payable	37,000	45,000	Account receivable	70,000	1,40,000
Dividend payable	50,000	35,000	Cash	30,000	10,000
11,30,000		12,65,000	11,30,000		12,65,000

Solution:

Statement of changes in Working Capital

Particulars	2005 Rs.	2006 Rs.	Effect on working capital Increase Rs.	Decrease Rs.
Current Assets:				
Cash	30,000	10,000		20,000
Accounts Receivable	70,000	1,40,000	70,000	
Stock-in-trade	1,50,000	2,25,000	75,000	
Work-in-progress	80,000	90,000	10,000	
Total Current Assets	3,30,000	4,65,000		
Tax payable	77,000	43,000	34,000	
Accounts payable	96,000	1,92,000		96,000
Interest payable	37,000	45,000		8,000
Dividend payable	50,000	35,000	15,000	
Total Current Liabilities	2,60,000	3,15,000		
Working Capital (CA-CL)	70,000	1,50,000		
Net increase in				
Working capital (B/f)	80,000			80,000
Total	1,50,000	1,50,000	2,04,000	2,04,000

Illustration 2

Calculate the fund from operation from the following details as on 31st March, 2007.

1. Net profit for the year ended 31st March, 2007 Rs. 6,50,000.
2. Gain on sale of building Rs. 35,500.
3. Written of Goodwill 10% from the book value of Rs. 1,80,000.
4. Old machine sold for Rs. 6,500 worth Rs. 8,000.
5. Rs. 1,25,000 have been transferred to the general reserve fund.
6. Rs. 1,30,000 is provided for Depreciation.

Solution:**Adjusted Profit and Loss Account**

	Rs.		Rs.
To Goodwill	18,000	By sale of building (gain)	35,500
To loss on sale of machinery	1,500	By balance c/d (Fund from operation)	8,89,000
To general reserve	1,25,000		
To depreciation	1,30,000		
To closing balance	6,50,000		
	9,24,500		9,24,500

Fund from operational can be calculated alternatively in a statement form.

Net profit of the year	6,50,000
<i>Add:</i> Non-operating expenditure	
Goodwill written-off	18,000
Loss on sale of machinery	1,500
General reserve	1,25,000
Depreciation	1,30,000
	<u>2,74,500</u>
	9,24,500
<i>Less:</i> Non-operating incomes	
Gain on sale of buildings	35,500
Fund from operation	<u>8,89,000</u>

Illustration 3

From the following details calculate fund from operations:

	Rs.
Opening balance of Profit & Loss A/c	25,000
Salaries	5,000
Discount on issue of debentures	2,000
Rent	3,000
Provision for bad debts	1,000
Transfer to G. Reserve	1,000
Refund of Tax	3,000
Profit on sale of building	5,000
Depreciation on plant	5,000
Preliminary exp. written-off	2,000
Goodwill written-off	3,000
Loss on sale of plant	2,000
Provision for tax	4,000
Dividend received	5,000
Closing balance of Profit & Loss A/c	60,000
Proposed Dividend	6,000

Solution:**Adjusted Profit and Loss Account**

To balance b/d	60,000	By profit on sale of building	5,000
To depreciation on plant	5,000	By refund of tax	3,000
To provision for tax	4,000	By dividend value	5,000
To loss on sale of plant	2,000	By Balance b/d	25,000
To discount on issue of debentures	2,000	By Balance c/d	48,000
		(fund from operation)	
To provision for bad debts	1,000		
To G. reserve (transfer)	1,000		
To Prel. Exp. written-off	2,000		
To Goodwill written-off	3,000		
To proposed dividend	6,000		
	86,000		86,000

Alternatively,

Net Profit (difference between opening and closing balance)	35,000
Add : Provision for bad debts	1,000
G. Reserve (transfer)	1,000
Depreciation	5,000
Provision for tax	4,000
Goodwill written-off	3,000
Prel. Exp. written-off	2,000
Discount on issue of debentures	2,000
Proposed dividend	6,000
Loss on sale of plant	2,000
	<u>26,000</u>
	61,000
Refund of Tax	3,000
Dividend received	5,000
Profit on sale of building	5,000
Fund from operation	<u>13,000</u>
	<u>48,000</u>

Illustration 4

A company reported current profit of Rs. 70,000 after incorporating the following:

Loss on sale of equipment 10,000 Gain from sale of non-current assets 4,000

Premium on redemption of 1,500 Excess provision of taxation 22,000

Debentures

Loss on sale of equipment	10,000	Gain from sale of non-current assets	4,000
Premium on redemption of debentures	1,500	Excess provision of taxation	22,000
Discount on issue of debentures	2,000	Dividend income	4,000
Depreciation on machinery and Building	20,000	General Reserve	5,000
Depletion of natural resources	10,000	Preliminary expenses	1,000
Amortization of goodwill	30,000	Profit on revaluation of Investment	2,500
Interim dividend	25,000		

Derive the net inflow of funds from the operation.

Solution

Net profit		70,000	
Add : Non-Operation Expenses:			
Loss on sale of equipment	10,000		
Depreciation of natural resources	10,000		
Discount on issue of debentures	2,000		
Depreciation on machinery	20,000		
Amortization of goodwill	30,000		
Interim dividend	25,000		
Provision for tax	22,000		
G. Reserve	5,000		
Prel. Exp.	1,000		
		1,25,000	
		<u>1,95,000</u>	
Less : Non-operating income:			
Dividend Income	4,000		
Gain from sale of non-current assets	4,000	8,000	
Net fund from operation		<u>1,87,000</u>	

Illustration 5

From the following balance sheets of ABC Ltd., on 31-12-2005 and 2006 prepare a schedule of changes in working capital and fund flow statement.

Liabilities			Assets		
	2005	2006		2005	2006
	Rs.	Rs.		Rs.	Rs.
Share Capital	1,00,000	1,00,000	Goodwill	12,000	12,000
General Reserve	14,000	18,000	Buildings	40,000	36,000
P & L A/c	16,000	13,000	Plant	37,000	36,000
Sundry Creditors	8,000	5,400	Investment	10,000	11,000
Bills payable	1,200	800	Stock	30,000	23,400
Provision for tax	16,000	18,000	Bills receivable	2,000	3,200
Provision for Doubtful debts	400	600	Debtors	18,000	19,000
			Cash at bank	6,600	15,200
	1,55,600	1,55,800		1,55,600	1,55,800

Adjustments

1. Depreciation charges on plant and buildings Rs. 4,000 each.
2. Provision for taxation of Rs. 19,000 was made during the year 2006.
3. Interim dividend of Rs. 8,000 was paid during the year 2006.

Solution

Step-I

Schedule of Changes in Working Capital

Particulars	2005	2006	Effect on working capital	
			+	-
Current Assets				
Stock	30,000	23,400	-	6,600
B/R	2,000	3,200	1,200	
Drs.	18,000	19,000	1,000	
Cash	6,600	15,200	8,600	
Total	56,600	60,800		
Current Liabilities				
Crs.	8,000	5,400	2,600	
B/P	1,200	800	400	
Total CL	9,200	6,200		
W/C (CA - CL)	47,400	54,600		
W/C (+)	7,200			7,200
	54,600	54,600	13,800	13,800

Increase in working capital Rs. 7,200

Step-II

Plant A/c

	Rs.		Rs.
To bal. b/d	37,000	By Dep. (Ad P & L A/c)	4,000
To cash purchase (Bal.)	3,000	By Bal. c/d	36,000
	40,000		40,000

Buildings A/c

	Rs.		Rs.
To bal. b/d	40,000	By Dep. (Ad P&L a/c)	4,000
		By Bal. c/d	36,000
	40,000		40,000

Investments A/c

	Rs.		Rs.
To bal. b/d	10,000		
To Cash Purchase (Bal.)	1,000	By Bal. c/d	11,000
	11,000		11,000

Provision for Taxation A/c

	Rs.		Rs.
To bal. (tax paid)	17,000	By bal. b/d	16,000
To bal. c/d	18,000	By Ad P&L a/c (Provision)	19,000
	35,000		35,000

Provision for Doubtful A/c

	Rs.		Rs.
To bal. c/d	600	By bal. b/d	400
		By Ad P&L a/c (Bal.)	200
	600		600

General Reserve A/c

	Rs.		Rs.
To bal. c/d	18,000	By bal. b/d	14,000
		By Ad P&L a/c (Bal.)	4,000
	18,000		18,000

Adjusted P&L A/c

	Rs.		Rs.
To dep. on plant	4,000	By bal. b/d	16,000
To dep. on building	4,000	By FFO (Bal.) (1)	36,200
To prov. for tax	19,000		
To General Reserve	4,000		
To provision for doubtful debts	200		
To interim dividend	8,000		
To bal c/d	<u>13,000</u>		
	52,200		52,200

Step-IV**Fund Flow Statement**

Fund Inflow	Rs.	Fund Outflow	Rs.
FFO (1)	36,200	Purchase of plant (2)	3,000
		Purchase of investment (3)	1,000
		Payment of tax (4)	17,000
		Payment of dividend (5)	8,000
		Working capital	7,200
	<u>36,200</u>		<u>36,200</u>

Note:

- (5) is given in the adjustment.
- Provision for doubtful debts may be reduced from Drs. Alternatively.
- Account for General Reserve may or may not prepared. We can take the difference directly.
- FFO means Fund from Operation

6. SUMMARY

- For the purpose of fund flow statement, the term fund means net working capital.
- The flow of fund will occur in a business, when a transaction results in a change i.e., increase or decrease in the amount of fund.
- According to Robert Anthony, the Fund Flow Statement describes the sources from which additional funds were derived and the uses to which these funds were put.
- The main purposes of Fund Flow Statement are:
 1. To help to understand the changes in assets and asset sources which are not readily evident in the income statement or financial statement.
 2. To inform as to how the loans to the business have been used.
 3. To point out the financial strengths and weaknesses of the business.
- The steps involved in the preparation of Fund Flow Statement are:
 1. Preparation of schedule changes in working capital.
 2. Preparation of adjusted profit and loss account.
 3. Preparation of accounts for non-current items.
 4. Preparation of the fund flow statement.

7. TERMINAL QUESTIONS

1. What are the objectives of Fund Flow Statement?
2. Explain the different steps involved in preparation of Fund Flow Statements.
3. Give the Format of Adjusted Profit and Loss Account.

8. ANSWERS

Self-Assessment Questions

1. Net working capital
2. Increase or decrease in the amount of fund
3. Robert Anthony
4. All the above

Terminal Questions

1. The main purposes of Fund Flow Statement are:
 - To help to understand the changes in assets and asset sources which are not readily evident in the income statement or financial statement.
 - To inform as to how the loans to the business have been used.
 - To point out the financial strengths and weaknesses of the business
2. The steps to prepare a fund flow statement are:
 - Preparation of schedule changes in working capital (taking current items only).
 - Preparation of adjusted profit and loss account (to know fund from [or] fund lost in operations).
 - Preparation of accounts for non-current items (Ascertain the hidden information).
 - Preparation of the fund flow statement.