Chapter 15

FUNDS FLOW STATEMENT AND CASH FLOW STATEMENT

CHAPTER OVERVIEW

(1)	(2)	(3)
Funds Flow Statement	**Cash Flow Statement**	**Distinctions**
Procedure for preparing the Funds Flow Statement 1. Analysis of Current Assets and Current Liabilities 2. Analysis of Non–Current Assets and Non–Current Liabilities 3. Analysis of Profit 4. Preparation of Funds Flow Statement	Procedure for preparing the Funds Flow Statement using (a) Direct Method and (b) Indirect Method	1. Funds Flow Statement vs Income & Expenditure A/c 2. Funds Flow Statement vs Balance Sheet 3. Funds Flow Statement vs Cash Flow Statement

1. FUNDS FLOW STATEMENT

1. Describe the procedure for preparing the Funds Flow Statement.

Stage	Procedure
1	Prepare the **Schedule of Changes in Net Working Capital**, and ascertain the Increase / Decrease. [**Note**: Current Assets and Current Liabilities items will be considered in this Schedule.]
2	Analyse the Non–Current Assets and Non–Current Liability accounts, viz. Fixed Assets, Investments, Capital, Loans, etc. to ascertain movement of funds as under – • **Fixed Assets:** Sale / Disposal or Fresh Purchase of Fixed Assets. • **Investments:** Sale of Investments or additional investments made during the year. • **Capital:** Redemption / Buyback of Shares or Fresh Issue of Capital (at premium, if any). • **Loans:** Repayment of Loans or Additional Borrowing during the year. [**Note**: In the course of analysis in Stage 2, – (a) **Non–Cash Items** (like Depreciation, Transfer to Reserves, etc, and (b) **Non–Operating Items / Adjustments** (e.g. Profit / Loss on sale of assets / investments, etc.) will also be identified.]
3	Compute **Funds from Operations (FFO),** i.e. Surplus generated from activities during the period. **FFO** = Profit during the year + Adjustments in respect of Depreciation, Amortisations and Write–Offs, Transfers to Reserves, Dividend declared, etc.
4	Prepare the Statement of Sources and Application of Funds (i.e. **Funds Flow Statement**) showing the various fund movements during the period.

2. CASH FLOW STATEMENT

2. Describe the procedure for preparing the Cash Flow Statement.

Cash Flow Statement is an **Analytical Reconciliation Statement** of the difference in Cash and Bank, as under –

Closing Balance of Cash & Cash Equivalents **(Less) Opening Balance** of Cash & Cash Equivalents
= Increase / Decrease in Cash and Cash Equivalents during the year, attributed to –

Operating Activities	Investing Activities	Financing Activities
Cash Generated from Operations, computed as under –	Changes (increase / decrease) in Investments & Long–Term Assets	Changes (increase / decrease) in Capital and Long–Term Liabilities
EBT + Non–Cash Items ± Non–Operating Items Operating Profit before WC Adjustments ± Adjustment for Working Capital Changes Cash flow before Taxes (–) Taxes paid Cash Flow from Operating Activities	**Note:** Long Term Assets items / movements should be considered under this Heading. Examples – • Purchase / Sale of Fixed Assets and Long–Term Investments. • Income from Long–Term Investments.	**Note:** Long Term Liability items / movements should be considered under this Heading. Examples – • Issue / Redemption of Equity Capital, Preference Capital, & Debt • Interest paid on Debt, & Dividend paid on Equity & Preference Capital.

Format: The **Direct Method** of reporting Cash Flows from Operating Activities is illustrated below –

Particulars	Amount	Amount
Cash Receipts from Customers for sale of goods / rendering of services Cash Receipts from Royalties, fees, commission and other revenue Cash Payments to Suppliers for goods and services Cash Payments to and on behalf of Employees Cash receipts and payments relating to futures / forward / option / swap contracts when the contracts are held for dealing or trading purposes.		
Cash Generated from Operations before taxes and extraordinary items		
Less: Cash Payments (Refunds) of income taxes unless they can be specifically identified with financing and investing activities		
Cash Flows before extraordinary items		
Add / Less: Cash Receipts (Payments) in relation to extraordinary items, e.g. earthquake disaster settlement, etc.		
NET CASH FROM OPERATING ACTIVITIES		

Note: For a Financial Enterprise, Interest Received & Interest Paid would constitute Operating Cash Flows.

Format: The **Indirect Method** of reporting Cash Flows from Operating Activities is illustrated below:

Particulars	Amount	Amount
Net Profit before Taxes and Extra–ordinary Items **Adjustments for:** Depreciation and similar non–cash items Foreign Exchange Losses, if any Interest / Dividend / Other Incomes relating to investing / financing activities Interest Paid Taxes Paid (if PAT is considered initially instead of PBT)		
Operating Profit before Working Capital Changes		
Add / (Less): Decrease / (Increase) in Current Assets excluding Cash / Cash Equivalents. Increase / (Decrease) in Current Liabilities excluding Cash / Cash Equivalents		
Cash Generated From Operations		
Less: Cash Payments (Refunds) of income taxes unless they can be specifically identified with financing and investing activities		
Cash Flows before extraordinary items		
Add / Less: Cash Receipts (Payments) in relation to extraordinary items, if any		
NET CASH FROM OPERATING ACTIVITIES		

ILLUSTRATIONS ON FUNDS FLOW STATEMENT

Stage	Procedure
1	Prepare the **Schedule of Changes in Net Working Capital**, and ascertain the Increase / Decrease. [**Note**: Current Assets and Current Liabilities items will be considered in this Schedule.]
2	Analyse the Non–Current Assets and Non–Current Liability accounts, viz. Fixed Assets, Investments, Capital, Loans, etc. to ascertain movement of funds as under – • **Fixed Assets:** Sale / Disposal or Fresh Purchase of Fixed Assets. • **Investments:** Sale of Investments or additional investments made during the year. • **Capital:** Redemption / Buyback of Shares or Fresh Issue of Capital (at premium, if any). • **Loans:** Repayment of Loans or Additional Borrowing during the year. [**Note**: In the course of analysis in Stage 2, – (a) **Non–Cash Items** (like Depreciation, Transfer to Reserves, etc, and (b) **Non–Operating Items / Adjustments** (e.g. Profit / Loss on sale of assets / investments, etc.) will also be identified.]
3	Compute **Funds from Operations (FFO),** i.e. Surplus generated from activities during the period. **FFO** = Profit during the year + Adjustments in respect of Depreciation, Amortisations and Write–Offs, Transfers to Reserves, Dividend declared, etc.
4	Prepare the Statement of Sources and Application of Funds (i.e. **Funds Flow Statement**) showing the various fund movements during the period.

Illustration 1: Funds Flow Statement with Balance Sheets and Additional Information **M 09**

Balance Sheets of RST Limited as on 31st March 2008 and 31st March 2009 are as under: (in Rs.)

Liabilities	31.3.2008	31.3.2009	Assets	31.3.2008	31.3.2009
Equity Capital (Rs.10 per Share)	10,00,000	12,00,000	Land & Building	6,00,000	7,00,000
General Reserve	3,50,000	2,00,000	Plant & Machinery	9,00,000	11,00,000
9% Preference Share Capital	3,00,000	5,00,000	Investments (Long Term)	2,50,000	2,50,000
Share Premium A/c	25,000	4,000	Stock	3,60,000	3,50,000
Profit & Loss A/c	2,00,000	3,00,000	Debtors	3,00,000	3,90,000
8% Debentures	3,00,000	1,00,000	Cash & Bank	1,00,000	95,000
Creditors	2,05,000	3,00,000	Prepaid Expenses	15,000	20,000
Bills Payable	45,000	81,000	Advance Tax Payment	80,000	1,05,000
Provision for Tax	70,000	1,00,000	Preliminary Expenses	40,000	35,000
Proposed Dividend	1,50,000	2,60,000			
Total	26,45,000	30,45,000	Total	26,45,000	30,45,000

Additional information:

- **Depreciation charged on Building and Plant & Machinery during 2008–09 were Rs.50,000 and Rs.1,20,000 respectively.**
- **During the year, an old Machine costing Rs.1,50,000 was sold for Rs.32,000. Its WDV was Rs.40,000 on the date of sale.**
- **During the year, Income Tax for the year 2007–08 was assessed at Rs.76,000. A cheque of Rs.4,000 was received along with the assessment order towards refund of Income Tax paid in excess, by way of advance tax in earlier years.**
- **Proposed Dividend for 2007–08 was paid during the year 2008–09.**
- **9% Preference Shares of Rs.3,00,000 which were due for redemption, were redeemed during the year 2008–09 at a premium of 5% out of the proceeds of fresh issue of 9% Preference Shares.**
- **Bonus Shares were issued to the existing Equity Shareholders, at the rate of one Share for every five Shares held on 31.3.2008 out of General Reserves.**
- **Debentures were redeemed at the beginning of the year at a premium of 3%.**
- **Interim Dividend paid during the year 2008–09 was Rs.50,000.**

Required: (a) Schedule of Changes in Working Capital, & (b) Funds Flow Statement for year ended 31st March 2009.

Solution:

1. Schedule of Changes in Working Capital

Particulars		31.3.2008	31.03.2009	Increase	Decrease
A. Current Assets:	Stock–in–Trade	3,60,000	3,50,000		10,000
	Sundry Debtors	3,00,000	3,90,000	90,000	
	Prepaid Expenses	15,000	20,000	5,000	
	Cash and Bank Balances	1,00,000	95,000		5,000
	Sub–Total Current Assets	**7,75,000**	**8,55,000**	**95,000**	**15,000**
B. Current Liabilities:	Sundry Creditors	2,05,000	3,00,000	95,000	
	Bills Payable	45,000	81,000	36,000	
	Sub–Total Current Liabilities	**2,50,000**	**3,81,000**	**1,31,000**	
C. Net Working Capital		5,25,000	4,74,000	(36,000)	15,000
Adjustment:	**Decrease** in Working Capital		51,000	51,000	
Total		**5,25,000**	**5,25,000**	**15,000**	**15,000**

2. Assets A/c

Particulars	L&B	P&M	Particulars	L&B	P&M
To balance b/d (given)	6,00,000	9,00,000	By Depreciation A/c (given)	50,000	1,20,000
			By Bank (Sale of Asset)	–	32,000
To Bank–asset addns during the year (balancing figure)	**1,50,000**	**3,60,000**	By P&L A/c (Loss on sale)	–	8,000
			By balance c/d (given)	7,00,000	11,00,000
Total	**7,50,000**	**12,60,000**	**Total**	**7,50,000**	**12,60,000**

3. Advance Tax A/c

Particulars	Rs.	Particulars	Rs.
To balance b/d (given) (Adv. Tax for 2007–08)	80,000	By Bank (refund recd for 2007–08)	4,000
		By Provn for Taxation 2007–08 (**transfer**)	**76,000**
To Bank– Advance Tax for 2008–09 (given)	1,05,000	By balance c/d (given in B/s)	1,05,000
Total	**1,85,000**	**Total**	**1,85,000**

4. Provision for Taxation A/c

Particulars	Rs.	Particulars	Rs.
To Advance Tax (2007–08) A/c (transfer)	76,000	By bal. b/d (given) (for 2007–08)	70,000
		By P&L A/c (Addnl Provn 2007–08)	**6,000**
To balance c/d (given in B/s)	1,00,000	By P&L A/c – Provision for 2008–09	1,00,000
Total	**1,76,000**	**Total**	**1,76,000**

5. Payments towards Redemption

Particulars	Face Value	Premium on Redemption	Total Payment
Preference Shares (Old)	(in B/s) Rs.3,00,000	5% on Rs.3,00,000 = Rs.15,000	Rs.3,15,000
Debentures	3L – 1L = Rs.2,00,000	3% on Rs.2,00,000 = Rs. 6,000	Rs.2,06,000

6. Details of Fresh Capital Issued

- Since all old Preference Shares are redeemed, the amount of Rs.5,00,000 as on 31.03.2009 represents the proceeds of fresh Preference Shares issued during the year.
- Bonus Issue = 1 Share for every 5 Share held = 1/5 of Rs.10,00,000 Equity Capital = Rs.2,00,000. Thus, there is no fresh inflow of funds as such towards Equity Share Capital.

7. Securities Premium A/c

Particulars	Rs.	Particulars	Rs.
To Pref. Shareholders (Premium)	15,000	By balance b/d (given)	25,000
To Debentureholders (Premium)	6,000		
To balance c/d (given in B/s)	4,000		
Total	**25,000**	**Total**	**25,000**

8. General Reserve A/c

Particulars	Rs.	Particulars	Rs.
To Equity Shareholders (Bonus Issue)		By balance b/d (given)	3,50,000
($1/5^{th}$ of Rs.10,00,000)	2,00,000	By P&L A/c (transfer during the year)	**50,000**
To balance c/d (given in B/s)	2,00,000	Balancing Figure	
Total	**4,00,000**	**Total**	**4,00,000**

9. Adjusted P & L A/c (to compute Funds from Operations)

Particulars	Rs.	Particulars	Rs.
To Prelim. Exps w/off (Rs.40,000 – Rs.35,000)	5,000	By balance c/d (Opening Balance in P&L A/c)	2,00,000
To Depreciation on Plant & Machinery	1,20,000	By Funds from Operations **(bal. fig.)**	**7,49,000**
To Depreciation on Building	50,000		
To Loss on Sale of M/c	8,000		
To Provision for Taxation (extra for 2007–08)	6,000		
To Provision for Taxation (for 2008–09)	1,00,000		
To Dividend for 2008–09: Interim	50,000		
Proposed	2,60,000		
To General Reserve – transfer	50,000		
To balance c/d (Closing Balance in P & L A/c)	3,00,000		
Total	**9,49,000**	**Total**	**9,49,000**

10. Statement of Sources and Application of Funds (Funds Flow Statement)

Sources of Funds		Rs.	Application of Funds		Rs.
Funds from Operations	**(WN 9)**	7,49,000	Purchase of Plant & M/c	**(WN 2)**	3,60,000
Sale of Machinery	**(given)**	32,000	Additions to Building	**(WN 2)**	1,50,000
Issue of Preference Share Capital		5,00,000	Redemption of Debentures	**(WN 5)**	2,06,000
Decrease in Working Capital	**(WN 1)**	51,000	Redemption of Preference Shares	**(WN 5)**	3,15,000
Refund of Income Tax (2007–08)		4,000	Advance Tax paid (2008–09)	**(WN 3)**	1,05,000
			Final Dividend paid (2007–08)		1,50,000
			Interim Dividend paid (2008–09)		50,000
Total		**13,36,000**	**Total**		**13,36,000**

Illustration 2: Funds Flow Statement with Balance Sheets and Additional Information **N 08**

Balance Sheets of OP Ltd as on 31st March 2007 and 2008 are as follows –

Liabilities	31.03.07	31.03.08	Assets	31.03.07	31.03.08
Share Capital	20,00,000	20,00,000	**Land and Buildings**	15,00,000	14,00,000
General Reserve	4,00,000	4,50,000	**Plant and Machinery**	18,00,000	17,50,000
Profit and Loss Account	2,50,000	3,60,000	**Investment**	4,00,000	3,72,000
10% Debentures	10,00,000	8,00,000	**Stock**	4,80,000	8,50,000
Bank Loan (Long – Term)	5,00,000	6,00,000	**Debtors**	6,00,000	7,98,000
Creditors	4,00,000	5,80,000	**Prepaid Expenses**	50,000	40,000
Outstanding Expenses	20,000	25,000	**Cash and Bank**	1,40,000	85,000
Proposed Dividend	3,00,000	3,60,000			
Provision for Taxation	1,00,000	1,20,000			
Total	49,70,000	52,95,000	**Total**	49,70,000	52,95,000

Additional Information:

- **New Machinery for Rs.3,00,000 was purchased but an Old Machinery costing Rs.1,45,000 was sold for Rs.50,000, and Accumulated Depreciation thereon was Rs.75,000.**
- **10% Debentures were redeemed at 20% premium.**
- **Investments were sold for Rs.45,000, and its profit was transferred to General Reserve.**
- **Income Tax paid during the year 2007–2008 was Rs.80,000.**
- **An Interim Dividend of Rs.1,20,000 has been paid during the year 2007–2008.**

- **Assume the Provision for Taxation as Current Liability and Proposed Dividend as Non–Current Liability.**
- **Investments are Non–Trade investments.**

Prepare – (a) Schedule of Changes in Working Capital, and (b) Funds Flow Statement.

Solution: **1. Schedule of Changes in Working Capital**

Particulars		31.03.2007	31.03.2008	Increase	Decrease
A. Current Assets:	Stock	4,80,000	8,50,000	3,70,000	–
	Debtors	6,00,000	7,98,000	1,98,000	–
	Prepaid Expenses	50,000	40,000	–	10,000
	Cash and Bank balances	1,40,000	85,000	–	55,000
	Sub–Total Current Assets	**12,70,000**	**17,73,000**	**5,68,000**	**65,000**
B. Current Liabilities:	Creditors	4,00,000	5,80,000	1,80,000	–
	Outstanding Expenses	20,000	25,000	5,000	–
	Provision for Taxation	1,00,000	1,20,000	20,000	–
	Sub–Total Current Liabilities	**5,20,000**	**7,25,000**	**2,05,000**	**–**
C. Net Working Capital		7,50,000	10,48,000	3,63,000	65,000
Adjustment:	**Increase** in Working Capital	**2,98,000**	–		**2,98,000**
Total		**10,48,000**	**10,48,000**	**3,63,000**	**3,63,000**

2. Analysis of Non–Current Asset & Non–Current Liability Accounts and movements therein

(a) Investments A/c

Particulars	Rs.	Particulars	Rs.
To balance b/d – Opening balance (given)	4,00,000	By Bank (Sale Proceeds) (given)	45,000
To General Reserve (Pft on Sale transfer)	**17,000**	By balance c/d – Closing balance (given)	3,72,000
Total	**4,17,000**	**Total**	**4,17,000**

(b) Plant and Machinery A/c

Particulars	Rs.	Particulars	Rs.
To balance b/d – Opg balance (given)	18,00,000	By Bank (Sale Proceeds of M/c) given	50,000
To Bank – New m/c purchased (given)	3,00,000	By P&L A/c (Loss on Sale of Machine) (1,45,000 – 75,000 – 50,000)	20,000
		By P&L A/c (Deprn for the year) (bal.fig)	**2,80,000**
		By balance c/d – Closing balance (given)	17,50,000
Total	**21,00,000**	**Total**	**21,00,000**

(c) Depreciation on Buildings during the year = Closing Bal. **less** Opening Bal. = Rs.15,00,000 – Rs.14,00,000 = **Rs.1,00,000.**

(d) Transfer to General Reserve out of current profits = Rs.4,50,000 – Rs.4,00,000 – Invt transfer Rs.17,000 = **Rs.33,000.**

(e) Amount paid on redemption of Debentures = (Rs.10,00,000 – Rs.8,00,000) + 20% Premium = **Rs.2,40,000.**

3. Computation of Funds from Operations by preparing the **Adjusted P & L Account –**

Particulars	Rs.	Particulars	Rs.
To Loss on Sale of Machinery	20,000	By balance b/d – Opening balance (given)	2,50,000
To Depreciation on Plant & Machinery	2,80,000		
To Depreciation on Buildings	1,00,000		
To Premium on Redemption of Debentures	40,000		
To Transfer to General Reserve	33,000		
To Proposed Dividend	3,60,000	By Funds from Operations **(bal.fig)**	**9,43,000**
To balance c/d – Closing balance (given)	3,60,000		
Total	**11,93,000**	**Total**	**11,93,000**

4. Statement of Sources and Application of Funds (Funds Flow Statement)

Sources of Funds	Rs.	Application of Funds	Rs.
Funds from Operations	9,43,000	Increase in Working Capital	2,98,000
Bank Loan (Long Term)	1,00,000	Purchase of New Machinery	3,00,000
Sale of Old Machinery	50,000	Redemption of Debentures at Premium	2,40,000
Sale of Investments	45,000	Dividend Paid (Fin Year 2006 – 07)	3,00,000
Total	**11,38,000**	**Total**	**11,38,000**

Illustration 3: Funds Flow Statement with Balance Sheets and Additional Information N 05

The following are the Balance Sheets of Gama Limited for the year ending 31st March 2009 and 31st March 2010 –

Liabilities	31.03.2009	31.03.2010	Assets	31.03.2009	31.03.2010
Share Capital	6,75,000	7,87,500	Fixed Assets	11,25,000	13,50,000
General Reserves	2,25,000	2,81,250	Less: Accum. Depreciation	2,25,000	2,81,250
Capital Reserve (Profit on Sale of Invts)	–	11,250	Net Fixed Assets	9,00,000	10,68,750
Profit & Loss Account	1,12,500	2,25,000	Long–Term Invts (at cost)	2,02,500	2,02,500
15% Debentures	3,37,500	2,25,000	Stock (at cost)	2,25,000	3,03,750
Accrued Expenses	11,250	13,500	Debtors (See Note)	2,53,125	2,75,625
Creditors	1,80,000	2,81,250	Bills Receivables	45,000	73,125
Provision for Dividends	33,750	38,250	Prepaid Expenses	11,250	13,500
Provision for Taxation	78,750	85,500	Miscellaneous Expenditure	16,875	11,250
Total	16,53,750	19,48,500	Total	16,53,750	19,48,500

Note: Debtors are net of Provision for Doubtful Debts of Rs.45,000 and Rs.56,250 respectively for 2009 and 2010 respectively.

Additional Information:

1. During the year 2009–2010, Fixed Assets with a Net Book Value of Rs.11,250 (Accumulated Depreciation = Rs.33,750) was sold for Rs.9,000.
2. During 2009–2010, Investments costing Rs.90,000 were sold, and also Investments costing Rs.90,000 were purchased.
3. Debentures were retired at a premium of 10%.
4. Tax of Rs.61,875 was paid for 2008–2009.
5. During the year 2009–2010, Bad Debts of Rs.15,750 were written off against the Provision for Doubtful Debts A/c.
6. The Proposed Dividend for 2008–2009 was paid in 2009–2010.

Prepare a Funds Flow Statement (Statement of Changes in Financial Position on Working Capital basis) for the year ended 31st March 2010.

Solution: **1. Statement of Changes in Working Capital**

Particulars		31.03.2007	31.03.2008	Increase	Decrease
A. Current Assets:	Stock	2,25,000	3,03,750	78,750	
	Debtors (Net)	2,53,125	2,75,625	22,500	
	Bills Receivable	45,000	73,125	28,125	
	Prepaid Expenses	11,250	13,500	2,250	
Sub–Total Current Assets		**5,34,375**	**6,66,000**	**1,31,625**	
B. Current Liabilities:	Accrued Expenses	11,250	13,500	2,250	
	Creditors	1,80,000	2,81,250	1,01,250	
Sub–Total Current Liabilities		**1,91,250**	**2,94,750**	**1,03,500**	
C. Net Working Capital		3,43,125	3,71,250	**28,125**	
Adjustment:	**Increase** in Working Capital	**28,125**	–		**28,125**
Total		**3,71,250**	**3,71,250**	**28,125**	**28,125**

2. Analysis of Non–Current Assets & Non–Current Liabilities Accounts and movements therein

(a) Increase in Share Capital = Rs.7,87,500 – Rs.6,75,000 = Rs.1,12,500. **(Source of Fund)**

(b) Sale Proceeds of Investment = Cost + Profit = Rs.90,000 + 11,250 = Rs.1,01,250. **(Source of Fund)**

(c) Redemption of Debentures = (Rs.3,37,500 – Rs.2,25,000) + 10% = Rs.1,23,750. **(Application of Fund)**

(d) Tax Provision made during the year = Closing Balance + Tax paid – Opening Balance = 85,500 + 61,875 – 78,750 = Rs.68,625. **(taken to Adjusted P & L A/c)**.

(e) Gross Book Value of Asset Sold = Net Book Value + Accum. Depreciation = 11,250 + 33,750 = 45,000.

(f) Fixed Assets purchased during the year = Closing Balance + Gross Book Value of asset sold – Opening Balance = Rs.13,50,000 + Rs.45,000 – Rs.11,25,000 = Rs.2,70,000. **(Application of Fund)**

(g) Depreciation provided for the year = Closing Balance + Accum Deprn on Asset Sold – Opening balance = Rs.2,81,250 + Rs.33,750 – Rs.2,25,000 = Rs.90,000. **(taken to Adjusted P & L A/c)**.

(h) Misc. Exp. w/off during the year = Rs.16,875 – Rs.11,250 = Rs.5,625. **(taken to Adjusted P & L A/c)**.

3. Adjusted P & L A/c (to compute Funds from Operations)

Particulars	Rs.	Particulars	Rs.
To Misc. Expenditure written off	5,625	By balance c/d (Opening Bal. in P & L A/c)	1,12,500
To Provision for Depreciation	90,000	By Funds from Operations **(bal. fig.)**	**3,84,750**
To Loss on Sale of Asset (11,250 – 9,000)	2,250		
To Premium on Deb. Redemption	11,250		
To Provision for Taxation	68,625		
To Proposed Dividend for 2005	38,250		
To General Reserve – transfer	56,250		
To balance c/d (Closing Bal. in P & L A/c)	2,25,000		
Total	**4,97,250**	**Total**	**4,97,250**

4. Statement of Sources and Application of Funds (Funds Flow Statement)

Sources of Funds	Rs.	Application of Funds	Rs.
Funds from Operations (WN 3)	3,84,750	Purchase of Fixed Assets (WN 2f)	2,70,000
Sale of Fixed Assets (given)	9,000	Purchase of Investments (given)	90,000
Sale of Investments (WN 2b)	1,01,250	Redemption of Debentures (WN 2c)	1,23,750
Issue of Share Capital (WN 2a)	1,12,500	Payment of Taxes (given)	61,875
		Payment of Dividend (for 2004)	33,750
		Increase in Net Working Cap. (WN 1)	28,125
Total	**6,07,500**	**Total**	**6,07,500**

Illustration 4: Funds Flow Statement with Balance Sheets and P&L A/c **N 07**

Following are the Financial Statements of Zed Ltd (in Rs.)

Balance Sheets

Liabilities	31.03.07	31.03.06	Assets	31.03.07	31.03.06
Share Capital, Rs.10 par value	1,67,500	1,50,000	Land	3,600	3,600
Share premium	3,35,000	2,37,500	Building, net of depreciation	6,01,800	1,78,400
Reserves and Surplus	1,74,300	1,23,250	Machinery, net of depreciation	1,10,850	1,07,050
Debentures	2,40,000	–	Investment in 'A' Ltd.	75,000	–
Long–term loans	40,000	50,000	Stock	58,800	46,150
Creditors	28,800	27,100	Prepaid Expenses	1,900	2,300
Bank Overdraft	7,500	6,250	Debtors	76,350	77,150
Accrued expenses	4,350	4,600	Trade Investments	40,000	1,05,000
Income–Tax payable	48,250	16,850	Cash	77,400	95,900
Total	10,45,700	6,15,550	Total	10,45,700	6,15,550

Income Statement for the year ended March 31, 2007 (in Rs.)

	Net Sales	13,50,000
Less:	Cost of Goods Sold and Operating Expenses (including Depreciation on Buildings of Rs.6,600 and Depreciation on Machinery of Rs.11,400)	12,58,950
	Net Operating Profit	91,050
	Gain on sale of Trade Investments	6,400
	Gain on sale of Machinery	1,850

Profits before Tax	**99,300**
Income–Tax	**48,250**
Profits after Tax	**51,050**

Additional information:

- **Machinery with a Net Book Value of Rs.9,150 was sold during the year.**
- **The Shares of 'A' Ltd were acquired by issue of Debentures.**

Prepare a Funds Flow Statement (Statement of Changes in Financial position on Working Capital basis) for the year ended March 31, 2007.

Solution: **1. Statement of Changes in Working Capital**

Particulars		31.3.2008	31.03.2009	Increase	Decrease
A. Current Assets:	Stock	46,150	58,000	12,650	
	Prepaid Expenses	2,300	1,900		400
	Debtors	77,150	76,350		800
	Cash	95,900	77,400		18,500
Total Current Assets		**2,21,500**	**2,14,450**	**12,650**	**19,700**
B. Current Liabilities:	Creditors	27,100	28,800	1,700	
	Accrued Expenses	4,600	4,350		250
	Bank Overdraft	6,250	7,500	1,250	
Sub–Total		**37,950**	**40,650**	**2,950**	**250**
C. Net Working Capital		**1,83,550**	**1,73,800**	9,700	19,450
Adjustment:	**Decrease** in Working Capital		9,750	**9,750**	
Total		**1,83,550**	**1,83,550**	**19,450**	**19,450**

2. Fixed Assets Account

Particulars	Building	Machinery	Particulars	Building	Machinery
To balance b/d	1,78,400	1,07,050	By Depreciation	6,600	11,400
To Bank a/c **(bal. fig)**	**4,30,000**	**24,350**	By Machinery disposal a/c	–	9,1500
– assets acquired during the year			By balance c/d	6,01,800	1,10,850
	6,08,400	**1,31,400**		**6,08,400**	**1,31,400**

3. Proceeds from issue of Shares = Difference between Closing & Opening Balance in Share Capital & Share Premium a/c = (1,67,50 – 1,50,000) + (3,35,000 – 2,37,500) = Rs.17,500 + 97,500 = 1,15,000

4. Proceeds from issue of Debentures = 2,40,000 – 75,000 for investment in A Ltd = 1,65,000

5. Trade Investment Sold = Opening Bal. **Less** Closing Bal. + Gain on Sale = 1,05,000 – 40,000 + 6,400 = Rs.71,400

6. Amount received by Sale of Machinery = Book Value of M/c + Profit on Sale of Machinery = 9,150 + 1,850 = 11,000

7. Long Term Loan Repaid = Opening Balance – Closing Balance = 50,000 – 40,000 = 10,000.

8. Funds from operations = Operating Profit + Depreciation = 91,050 + 6,600 + 11,400 = 1,09,050

9. Funds Flow Statement (Statement of Sources and Application of Funds)

Sources of Funds		Rs.	Application of Funds	Rs.
Funds from Operation	**(WN 8)**	1,09,050	Purchase of Machinery **(WN 2)**	24,350
Sale of Machinery	**(WN 6)**	11,000	Purchase / Construction of Building	4,30,000
Sale of Trade Investment	**(WN 5)**	71,400	Income Tax paid (F.Y. 2005–06)	16,850
Debentures Issue	**(WN 4)**	1,65,000	Long Term Loan repaid **(WN 7)**	10,000
Proceeds from Share Issue	**(WN 3)**	1,15,000		
Decrease in Net Working Capital	**(WN 1)**	9,750		
		4,81,200		**4,81,200**

Illustration 5: Funds Flow Statement with Ratios and related data **M 08**

The Financial Statements and operating results of PQR revealed the following position as on 31st March 2006 –

Equity Share Capital (Rs.10 fully paid Share)	**Rs.20,00,000**
Working Capital	**Rs.6,00,000**
Bank Overdraft	**Rs.1,00,000**
Current Ratio	**2.5:1**
Liquidity Ratio	**1.5:1**
Proprietary Ratio (Net Fixed Assets ÷ Proprietary Fund)	**0.75:1**
Cost of Sales	**Rs.14,40,000**
Debtors Velocity	**2 months**
Stock Turnover based on Cost of Sales	**4 times**
Gross Profit Ratio	**20% of Sales**
Net Profit Ratio	**15% of Sales**

Closing Stock was 25% higher than the Opening Stock. There were also Free Reserves brought forward from earlier years. Current Assets include Stock, Debtors and Cash only. Current Liabilities except Bank Overdraft treated as Creditors. Expenses include Depreciation of Rs,90,000.

The following information was collected from the records for the year ended 31st March 2007 –

- **Total Sales for the year were 20% higher as compared to previous year.**
- **Balances as on 31st March 2007 were: Stock Rs.5,20,000, Creditors Rs.4,15,000, Debtors Rs.4,95,000 and Cash Balance Rs.3,10,000.**
- **Percentage of GP on Turnover has gone up from 20% to 25% and ratio of Net Profit to Sales from 15% to 16%.**
- **A portion of Fixed Assets was very old (Book Value Rs.1,80,000) disposed for Rs.90,000. (No depreciation to be provided on this item).**
- **Long–Term Investments were purchased for Rs. 2,96,600.**
- **Bank Overdraft fully discharged.**
- **Percentage of Depreciation to Fixed Assets to be provided at the rate in the previous year.**

Required:

- **Prepare Balance Sheets as on 31st March 2006 and 31st March 2007.**
- **Prepare the Funds Flow Statement for the year ended 31st March 2007.**

Solution: **1. Computation of Gross Profits and Net Profits for the Year 2007**

(a)	Year 2006 GP = 20%, Hence, COGS = 100%– 20%	= 80% of Sales
(b)	Year 2006 Sales = $\frac{\text{COGS}}{80\%} = \frac{\text{Rs.}14{,}40{,}000}{80\%}$	= Rs,18,00,000
(c)	Year 2007 Sales = 20% Higher than Year 2006 = Rs.18,00,000 + 20%	= Rs,21,60,000
(d)	Year 2007 GP = 25% on Sales = Rs,21,60,000 × 25%	= Rs. 5,40,000
(e)	Year 2007 NP = 16% on Sales = Rs,21,60,000 × 16%	= Rs. 3,45,600

2. Computation of Closing Stock

(a)	Stock Turnover for Year 2006 = $\frac{\text{COGS}}{\text{Average Stock}} = \frac{\text{Rs.}14{,}40{,}000}{\text{Average Stock}}$ = 4 times
(b)	So, Average Stock = $\frac{\text{Rs.}14{,}40{,}000}{4}$ = Rs,3,60,000. Let Opening Stock be = **x.** So, Closing Stock = x + 25%x = **1.25x**
(c)	On substitution, we have $\frac{x+1.25x}{2}$ = 3,60,000. On cross multiplication, 2.25x = 7,20,0000. So, **x = 3,20,000.**
(d)	So, Opening Stock = Rs.3,20,000, and Closing Stock = Rs.3,20,000 + 25% = Rs.4,00,000.

3. Debtors for Year 2006= Sales × $\frac{2}{12}$ = Rs.18,00,000 × $\frac{2}{12}$ = Rs.3,00,000.

4. Computation of Working Capital Components

(a)	Working Capital =Current Assets (CA)– Current Liabilities (CL)	= Rs. 6,00,000
(b)	Given that Current Ratio = 2.5 times. $\frac{CA}{CL}$ = 2.5 times. Hence, CA = 2.5CL. On substitution, 2.5 CL – CL = 6,00,000. On simplification, we get, CL= $\frac{Rs.6,00,000}{1.5}$	= Rs. 4,00,000
(c)	Of the Total CL, Bank O/D is Rs.1,00,000. So, Creditors = Rs.4,00,000 – Rs.1,00,000	= Rs. 3,00,000
(d)	Since CA= 2.5 CL, CA= 2.5 × Rs.4,00,000	= Rs.10,00,000
(e)	So, Cash = Total CA – Stock – Debtors = Rs.10,00,000 – Rs.4,00,000 – Rs.3,00,000	= Rs. 3,00,000

5. Computation of Gross and Net Fixed Assets

(a) Proprietary Ratio = $\frac{\text{Fixed Assets}}{\text{Proprietary Fund}} = \frac{FA}{FA + NWC} = \frac{FA}{FA + 6,00,000} = 0.75$

On solving, we get Fixed Assets (Net) =18,00,000

(b) Since Depreciation = Rs.90,000 (given), Gross Fixed Assets = Rs.18,90,000

(c) Rate of Depreciation for Year 2006= $\frac{Rs.90,000}{Rs.18,90,000}$ = 4.76%, Say **5%** (Rounded Off)

(d) Depreciation for Year 2007 = (Rs.18,00,000 – Rs.1,80,000) × 5% = Rs.81,000.

6. Balance Sheet as at 31.03.2006

Liabilities		Rs.	Assets			Rs.
Share Capital	(given)	20,00,000		Fixed Assets	**(WN 5)** 18,90,000	
Reserves & Surplus (balancing figure)		4,00,000	**Less:**	Depreciation (given)	90,000	18,00,000
Bank Overdraft	(given)	1,00,000	Stock	**(WN 2)**		4,00,000
Creditors	**(WN 4c)**	3,00,000	Debtors	**(WN 3)**		3,00,000
			Cash	**(WN 4)**		3,00,000
Total		**28,00,000**	**Total**			**28,00,000**

Note: Reserves include brought forwards Reserves + Year 2006 Profits.

7. Balance Sheet as at 31.03.2007

Liabilities		Rs.	Assets				Rs.
Share Capital	(given)	20,00,000		Fixed Assets		16,20,000	
Reserves and Surplus	(See Note)	7,45,600	**Less:**	Depreciation	**(WN 6)**	81,000	15,39,000
Creditors	(given)	4,15,000	Long Term Investments		(given)		2,96,600
			Stock		(given)		5,20,000
			Debtors		(given)		4,95,000
			Cash		(given)		3,10,000
Total		**31,60,600**	**Total**				**31,60,600**

Note: Reserves for Year 2007 = Year 2006 Balance + Profit for 2007 as per WN 1(e) = 4,00,000 +3,45,600.

8. Statement of Changes in Working Capital

Particulars		31.03.2006	31.03.2007	Increase	Decrease
A. Current Assets:	Stock	4,00,000	5,20,000	1,20,000	
	Debtors	3,00,000	4,95,000	1,95,000	
	Cash	3,00,000	3,10,000	10,000	
	Sub–Total Current Assets	**10,00,000**	**13,25,000**	3,25,000	
B. Current Liabilities:	Bank Overdraft	1,00,000	–		1,00,000
	Creditors	3,00,000	4,15,000	1,15,000	
	Sub–Total Current Liabilities	**4,00,000**	**4,15,000**	1,15,000	1,00,000
C. Net Working Capital		**6,00,000**	**9,10,000**	**2,10,000**	**(1,00,000)**
Adjustment:	**Increase** in Working Capital	3,10,000	–	–	3,10,000
Total		**9,10,000**	**9,10,000**	**2,10,000**	**2,10,000**

9. Funds Flow Statement for the year ended 31.03.2007

Sources	Rs.	Application	Rs.
Funds from Operations (Note)	5,16,600	Increase in Net Working Capital	3,10,000
Sale of Machinery Item	90,000	Investments purchased	2,96,600
Total	**6,06,600**	**Total**	**6,06,600**

Note: Funds from Operations = Net Profit for the year + Depreciation + Loss on Sale of Machinery
= Rs.3,45,600 + Rs.81,000 + Rs.90,000 = Rs.5,16,600

Illustration 6: Funds Flow Statement from Part Balance Sheet **RTP**

Given below is the Part Balance Sheet of Excellent Ltd. You are required to prepare Funds Flow Statement for the year ended 31st March 20X1.

Particulars	As at 31st March 20X0		As at 31st March 20X1	
Fixed Assets at cost	62,000		70,000	
Add: Addition during the year	8,000		17,000	
	70,000		87,000	
Less: Depreciation during the year	25,000	45,000	36,000	51,000
Current Assets				
Investment	10,000		15,000	
Stock at Cost	1,81,500		1,90,000	
Trade Debtors	1,31,500		1,38,700	
	3,23,000		3,43,700	
Less: Current Liabilities				
Bank Overdraft	1,16,000		55,000	
Trade Creditors and Provisions	99,800		1,19,200	
Proposed Dividend	16,000		24,000	
	2,31,800	91,200	1,98,200	1,45,500
Total Funds Employed		1,36,200		1,96,500

Solution: **1. Change in Working Capital**

(a) Increase in Total Current Assets (excluding Investment)	= Rs.3,28,700 – Rs.3,13,000	= Rs.15,700
(b) Increase in Trade Creditors & Provisions	= Rs.1,19,200 – Rs. 99,800	= Rs.19,400
(c) Decrease in Working Capital		**= Rs. 3,700**

2. Funds Flow Statement for the year 31st March 20X1

Sources of Funds	Rs.	Application of Funds	Rs.
Decrease in Working Capital (Note 1)	3,700	Purchase of Fixed Assets (given)	17,000
Funds from Operations (**balancing figure**)	95,300	Purchase of Investments (Rs.15,000 – Rs.10,000)	5,000
		Repayment of Bank OD (Rs.1,16,000 – Rs.55,000)	61,000
		Payment of Dividends	16,000
Total	**99,000**	**Total**	**99,000**

Note: In the absence of information, Funds from Operations has been taken as the balancing figure.

Illustration 7: Funds Flow Analysis – Long Term & Short Term Fund Movements

Where–Gone Co. has prepared the following projected Funds Flow Statement for the next year –

Sources of Funds		Rs. Lakhs	Application of Funds	Rs. Lakhs
1. Internal Accruals: Profit After Tax	1,000		1. Increase in Fixed Assets	800
Add: Depreciation	120		2. Increase in Investments	100
Less: Dividend (on Equity Capital of Rs.800 Lakhs)	(800)	320	3. Repayment of Term Loans	100
2. Increase in Public Fixed Deposits		150	4. Increase in Working Capital	170
3. Increase in Bank Cash Credits		500		
4. Increase in 7–year Debentures		200		
Total		1,170	Total	1,170

Give your critical comments to the Management on the projected Source and Application of Funds.

Solution: The Funds Flow Statement is analysed into long–term and short–term as under **(Rs. Lakhs)** –

Particulars	Long Term	Short Term	Total
A. Sources:			
1. Internal Accruals	320	–	320
2. Increase in Public Deposits	–	150	150
3. Increase in Bank Cash Credits	–	500	500
4. Increase in 7 years Debentures	200	–	200
Total Sources of Funds	**520**	**650**	**1,170**
B. Applications:			
1. Increase in Fixed Assets	800	–	800
2. Increase in Investments	100	–	100
3. Repayment of Term Loans	100	–	100
4. Increase in Working Capital	–	170	170
Total Application of Funds	**900**	**170**	**1,170**
C. Excess / (Shortfall) A – B	**(480)**	**480**	**–**

It is observed that short–term funds, i.e. Public Deposits and Cash Credits are raised to finance long–term uses viz. Fixed Assets. This violates the basic principle of financial management and adversely affects liquidity. The management has to consider the following –

1. Reduction in dividend, i.e. presently 100% on Equity Capital.
2. Need to increase investments when Public Deposits and Cash Credit limits are being raised.
3. Possibility of availing Medium or Long Term Loan to finance partly / fully Fixed Assets.
4. Need to follow the principle of one borrowing to repay another i.e.7 year debentures to repay term Loans.
5. Increase in Cash Credit (Current Liabilities) not reflected in increase in Working Capital (Current Assets)

Illustration 8: Funds Flow Analysis **RTP**

Ram Co. gives its Statement of Sources and Utilisation of Funds as under –

Sources of Funds	Rs.Lakhs	Application of Funds	Rs.Lakhs
Equity Share Capital	0.50	**Increase in Working Capital**	1.50
Loans at 12%	2.50	**Increase in Fixed Assets**	1.50
Reduction in Investments	0.25	**Loss as per P&L Account**	1.00
Sale of Assets	0.25		
Depreciation for the year	0.50		
Total	**4.00**	**Total**	**4.00**

The Company's Current Ratio at the beginning of the year was 2. The Current Liabilities of the Company as at 1st January (beginning of the year) stood at Rs.3 Lakhs. It was disclosed that during the year, the turnover to Capital Employed Ratio declined from 1.5 to 1.25. You are required to critically appraise the financial operations of the Company during the year.

Solution: **Analysis of Funds Flow Statement**

1. **Cash Loss during the year:** There is a total loss of Rs.1 Lakh of which Depreciation constitutes Rs.0.50 Lakh. Hence, the balance constitutes Cash Loss either due to reduction in sales prices or volume or increase in costs and overheads. Cash Loss is not a good sign for the Company vis–a–vis Going Concern.
2. **Reduction in Capital Turnover Ratio:** The Capital Turnover Ratio (i.e. $\frac{\text{Sales}}{\text{Capital Employed}}$) has come down from 1.50 to 1.25. The higher the turnover ratio, the better it is for the Firm. Fall in Capital Employed Turnover Ratio represents deterioration of activity levels and Sales, and also over–capitalization and idle funds with the Firm.
3. **Mismatch of funds:** Increase in Working Capital (a short–term application) has been financed out of long–term and permanent sources of funds (i.e. Share Capital, Loans at 12%, Sale of Investments and Assets). This is not a prudent financial practice, since there is no proper matching between long–term and short–term sources and applications.
4. **Debt Equity Funding:** In view of Cash Losses, the Firm should have gone in for obtaining equity funds since debt involves fixed commitment towards interest and principal. However, the Firm has obtained more Debt Funds at a cost of 12%, which may increase the Cash Losses in the subsequent years.
5. **Excessive Current Assets:** The Current Ratio at the start of the year was 2:1 which is a satisfactory one. However, during the year, there has been further increase in net Current Assets, which will cause a further increase in the Current Ratio. A high Current Ratio may indicate poor collection of Debtors, piling up of unsold Finished Goods, delays in production cycle and consequent increase in WIP, slow–moving Raw Materials, etc. The firm should monitor Working Capital items closely and adopt suitable techniques for maintaining a reasonable liquidity position.