Fund Flow Statement

Definition:

Fund Flow Statement implies a snapshot of the movement of funds, i.e. inflow or outflows of the firm's financial assets for a specific period. It represents, "**from where the funds are received and where the funds are utilised**" by the company during a particular period.

The word '**fund**'refers to a sum of money, which is used to finance the firm's day to day operations and acquire assets for the business. The **flow of funds** represents the movement of funds, i.e. the change in economic resources, from one asset or liability to another. In this way, the **fund flow statement** implies a method of analysing the changes in the firm's financial position, between two balance sheet dates.

Fund flow statement is useful in knowing the changes in the structure of assets, liabilities and capital. It shows whether the sources of funds coincides with its application and indicates the accuracy of a firm's financing and investment decisions. Unlike the cash flow statement, which is prepared on a cash basis, the fund flow statement is prepared on an accrual basis.

Meaning of Funds Flow Statement:

Funds flow statement is a statement which discloses the analytical information about the different sources of a fund and the application of the same in an accounting cycle. It deals with the transactions which change either the amount of current assets and current liabilities (in the form of decrease or increase in working capital) or fixed assets, long-term loans including ownership fund.

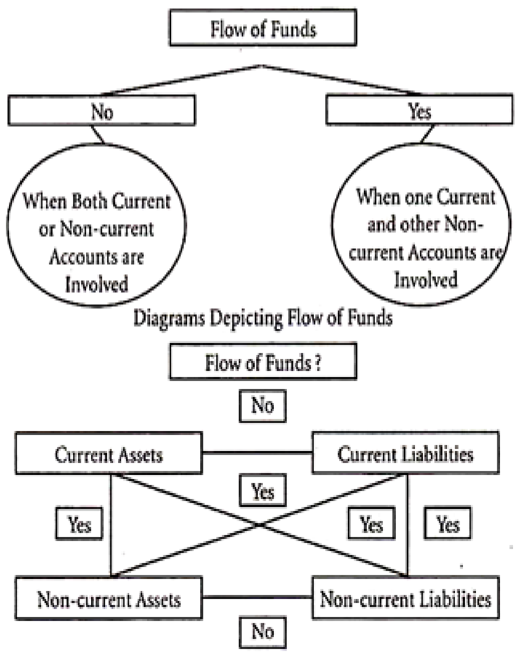
It gives a clear picture about the movement of funds between the opening and closing dates of the Balance Sheet. It is also called the Statement of Sources and Applications of Funds, Movement of Funds Statement; Where Got—Where Gone Statement: Inflow and Outflow of Fund Statement, etc. No doubt, Funds Flow Statement is an important indicator of financial analysis and control. It is valuable and also helps to determine how the funds are financed. The financial analyst can evaluate the future flows of a firm on the basis of past data.

This statement supplies an efficient method for the financial manager in order to assess the:

(a) Growth of the firm,
(b) Its resulting financial needs, and
(c) To determine the best way to finance those needs.

In particular, funds flow statements are very useful in planning intermediate and long-term financing.

Depicts flow of funds:



The above diagram clearly indicates that transactions –
(a) Between current assets and non-current assets and non-current liabilities will result in flow of funds.
(b) Between current liabilities and non-current assets and non-current liabilities will result in flow of funds.
(c) Between current assets and current liabilities will not result in flow of funds.
(d) Between non-current assets and non-current liabilities will not result in flow of funds.

Objective of Preparing a Fund Flow Statement:
The main purpose of preparing a Funds Flow Statement is that it reveals clearly the important items relating to sources and applications of funds of fixed assets, long-term loans including capital. It also informs how far the assets derived from normal activities of business are being utilized properly with adequate consideration.

Secondly, it also 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.
Thirdly, it also provides the information about the specific utilization of such funds, i.e. 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.

Lastly, it helps the management to prepare budgets and formulate the policies that will be adopted for future operational activities.

Significance and Importance of Funds Flow Statement:
Since traditional reports (i.e. Income Statement/Profit and Loss Account, and Balance Sheet) are not very informative, a financial analyst has to depend on some other report—Funds Flow Statement. In other words, along with the traditional sources of information, some other sources of information are absolutely required in order to take the challenge offered by modern business.
Funds Flow Statement, no doubt, caters to the needs of management. This is because a Funds Flow Statement not only presents the Balance Sheet values for consecutive two years, it also ascertains the changes of working capital—which is a very important indicator.
It not only reveals the source from which additional working capital has been financed but also, at the same time, the use of such funds. Moreover, from a projected funds flow statement the management can easily ascertain the adequacy or inadequacy of working capital, i.e., it helps in decision-making in a number of ways.

The significance and importance of Funds Flow Statements may be summarized as:

(a) Analysis of Financial Statement:
The traditional financial statements, viz. Profit and Loss Account and Balance Sheet, exhibit the result of the operation and financial position of a firm. Balance Sheet presents a static view about the resources and how the said resources have been utilized at a particular date with recording the changes in financial activities.

But Funds Flow Statement can do so, i.e., it explains the causes of changes so made and effect of such change in the firm accordingly.

(b) Highlighting Answers to Various Perplexing Questions:

(i) Causes of changes in Working Capital;

(ii) Whether the firm sells any Non-Current Asset; if sold, how were the proceeds utilized?

(iii) Why smaller amount of dividend is paid in spite of sufficient profit?

(iv) Where did the net profit go?

(v) Was it possible to pay more dividend than the present one?

(vi) Did the firm pay-off its scheduled debts? If so, how, and from what sources?

(vii) Sources of increased Working Capital, etc.

(c) Realistic Dividend Policy:

Sometimes it may so happen that a firm, instead of having sufficient profit, cannot pay dividend due to lack of liquid sources, viz. cash. In such a circumstance, Funds Flow Statement helps the firm to take decision about a sound dividend policy which is very helpful to the management.

(d) Proper Allocation of Resources:

Resources are always limited. So, it is the duty of the management to make its proper use. A projected Funds Flow Statement helps the management to take proper decision about the proper allocation of business resources in a best possible manner since it highlights the future.

(e) As a Future Guide:

A projected Funds Flow Statement acts as a business guide. It helps the management to make provision for the future for the necessary funds to be required on the basis of the problem faced. In other words, the future needs of the fund for various purposes can be known well in advance which is a very helpful guide to the management. In short, a firm may arrange funds on the basis of this statement in order to avoid the financial problem that may arise in future.

(f) Appraising of the Working Capital:

A projected Funds Flow Statement, no doubt, helps the management to know about how the working capital has been efficiently used and, at the same time, also suggests how to improve the working capital position for the future on the basis of the present problem faced by it, if any.

Preparation of Fund Flow Statement

Step 1: Preparation of Statement of Changes in Working Capital: Statement of Changes in working capital is a summary that shows the net increase or decrease in the working capital of the business.

The working capital of the firm increases if there is an increase in the current assets or decrease in the current liabilities. However, the working capital of the firm decreases if there is a decrease in the current assets and an increase in the current liabilities.

Further, there will be no change in the working capital if there is a realization from debtors or bills receivable or payment made to creditors or bills payable, goods are sold on credit and goods are purchased on credit.

Statement of Changes in Working Capital

Particulars	Previous Year	Current Year	Effect on working capital	
			Increase	Decrease
Current Assets: Cash in hand Debtor Inventory Bills Receivable				
Total Current Assets (A)				
Current Liabilities: Trade Creditors Bills Payable				
Total Current Liabilities (B)				
Total Working Capital (A-B)				
Change in Working Capital				

Step 2: Determination of Funds from Operations: Funds from operations refers to the profit earned or loss incurred from the regular business operation. The ascertainment of funds from the operation is vital for the preparation of fund flow statement.

Statement of Funds from Operations

Particulars		Amount
Net Profit After Tax for the year		xxx
Add: Non-Operating Expenses:		
Depreciation	xxx	
Loss on Sale of Fixed Assets	xxx	
Interest on Debentures	xxx	
Goodwill Written Off	xxx	
Provision for Tax	xxx	
Proposed Dividend	xxx	
Interim Dividend	xxx	
Transfer from Statement of Profit & Loss	xxx	xxx
Less: Non-Operating Incomes:		
Interest on Investment	xxx	
Dividend Received	xxx	
Profit on Sale of Fixed Assets	xxx	
Interest on Bank Deposit	xxx	
Refund of Tax	xxx	(xxx)
Net Fund Flow From Operations		xxx

Step 3: Preparation of Fund Flow Statement: After recognizing the funds/loss from operations, fund flow statement is prepared, which will show the net increase or decrease in the working capital.

Fund Flow Statement

Particulars	Amount
Sources of Funds:	
Funds from Operations	xxx
Sale of Fixed Assists	xxx
Sale of Investments	xxx
Issue of Shares	xxx
Issue of Debentures	xxx
Long Term Borrowings	xxx
Total (A)	**xxx**
Application of Funds:	
Loss from Operations	xxx
Payment of Dividend	xxx
Payment of Taxes	xxx
Purchase of Fixed Assets	xxx
Repayment of Loans	xxx
Redemption of Debentures	xxx
Redemption of Preference Shares	xxx
Total (B)	**xxx**
Net Increase or Decrease in Working Capital (A-B)	**xxx**

Basically, any change in the assets and liabilities may result in the inflows and outflows of funds, but not always, as in case of depreciation or revaluation of assets, there is no inflow or outflow of funds. Hence, only those assets or liabilities will become a part of the statement, which actually leads to the flows of the fund to/from the business.