BBA Sem-2

Corporate Accounting

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Unit -3

Preparation of fund flow statement (theory and examples)

- Meaning &importance of fund flow statement
- Difference between fund flow statement and and cash flow statement
- Statement showing changes in working capital
- Adjusted profit and loss account
- Examples fund flow statement

Meaning of fund flow statement

A fund flow statement reveals the periodic increase or decrease in a business enterprise's funds. The statement reflects the efficiency of financial management staff in generating funds from various sources and applying them to generate income without sacrificing the company's financial health.

The flow of funds refers to the transfer of economic value from one asset to another, from one equity to another, from one asset to equity, or from one equity to other assets (or a combination of any of these).

The term 'flow' indicates change, and hence, a fund flow refers to a change in funds or a change in working capital.

Funds flow into working capital from the sources of funds, which include trading profits, issue of shares and/or debentures, borrowings, sale of fixed assets, repayment of borrowings, payment of tax, dividends, and increase in working capital.

Hence, the difference between the sources and application of funds shows the net change in the working capital during the year/period. It is only those items that affect the net working capital of the business that find a place in this statement.

Thus, a fund flow statement is a financial statement that reveals the methods by which the business activities have been financed and how the enterprise has used its funds between the opening and closing balance sheet dates.

This is only a supplementary statement to 'time-honored statements (i.e., income statement and position statement, or balance sheet). The fund flow statement describes the sources from which additional funds were generated and the areas or items to which these funds are used or applied.

In a nutshell, transactions that increase working capital are sources of funds, whereas transactions that decrease working capital are applications of funds.

From the perspective of information users, the statement helps in understanding how efficiently funds are procured and how effectively the funds are employed.

importance of fund flow statement

1. It shows the various sources and uses or applications of funds between the two accounting periods.

2. Fund flow statements assist in determining the shift in amount of current assets investment and current liabilities financing.

3. It works as a crucial instrument for allocation of resources of a firm. It allows an organization for making plans for optimal allocation of resources.

4. It highlights the financial power and weak spots of a firm.

5. It help the investors to determine about how the company has employed the funds given by them & its financial strength. Based on comparative study of the past with the present, investors can identify & discover potential drains on funds in the future.

6. It assists the management to take remedial measures in case of deviations between two balance sheet figures.

7. It helps the investors for effective decisions at the time of their investment proposals.

8. It also offers detailed information concerning profitability, operational efficiency and financial matters of a firm.

9. It explains the connection between changes in working capital & net profits. Funds flow statements reveals the quantum of funds produced by operations.

10. It demonstrates the firms’ capacity to generate long-term financing to meet the investment in long-term assets.

11. It functions as a guide to the management to prepare its dividend, retention and investment policy, etc.

Table of Difference between Funds Flow Statement and Cash Flow Statement

	Basis of Difference	Funds Flow Statement	Cash Flow Statement
1.	**Basis of Analysis**	Funds flow statement is based on broader concept i.e. working capital.	Cash flow statement is based on narrow concept i.e. cash, which is only one of the elements of working capital.
2.	**Source**	Funds flow statement tells about the various sources from where the funds generated with various uses to which they are put.	Cash flow statement stars with the opening balance of cash and reaches to the closing balance of cash by proceeding through sources and uses.
3.	**Usage**	Funds flow statement is more useful in assessing the long-range financial strategy.	Cash flow statement is useful in understanding the short-term phenomena affecting the liquidity of the business.
4.	**Schedule of Changes in Working Capital**	In funds flow statement changes in current assets and current liabilities are shown through the schedule of changes in working capital.	In cash flow statement changes in current assets and current liabilities are shown in the cash flow statement itself.
5.	**End Result**	Funds flow statement shows the causes of changes in net working capital.	Cash flow statement shows the causes the changes in cash.
6.	**Principal of Accounting**	Funds flow statement is in alignment with the accrual basis of accounting.	In cash flow statement data obtained on accrual basis are converted into cash basis.

- **Statement showing changes in working capital**

Before preparing a statement of changes in working capital, the following important notes should be borne in mind:

1. An increase in current assets and a decrease in current liabilities increases working capital.
2. A decrease in current assets and an increase in current liabilities decreases working capital.

Steps to Follow to Prepare a Statement of Changes in Working Capital

First, draw the pro forma. Then, identify and enter all current assets under the heading of current assets. In turn, enter the current assets for the base year and current year in the respective columns.

Now, ascertain the difference in the current assets between the two periods. Enter the difference in the increase or decrease column, depending on the situation.

In turn, identify current liabilities and enter them under the heading of current liabilities. Then, enter the amount of current liabilities for the base year and current year in the respective columns.

The next step is to determine the difference in the current liabilities between the two periods. Enter the difference in the increase or decrease column, depending on the situation.

Add up the current assets and current liabilities for the previous year and current year. Denote the total current assets by A and current liabilities by B.

Calculate working capital for both the current period and base period by subtracting current liabilities (B) from current assets (A).

As the next step, compare the difference between the amount of working capital for the current and the base year.

If the working capital of the current year is greater than the working capital of the previous year, enter the difference in working capital in the previous year. In the relevant column, enter the increase in working capital against the amount written.

If the working capital of the current year is less than the working capital of the previous year, enter the difference in working capital in the current year. In the relevant column, enter the decrease in working capital against the amount written.

Finally, add up both of the columns for the previous and current years.

- **Statement showing changes in working capital format**

Particulars	Base Year ($)	Current Year ($)	Effect on Working Capital	
			Increase ($)	Decrease ($)
Current Assets				
Cash in hand	******	******	******	******
Cash at bank	******	******	******	******
Bills Receivable	******	******	******	******
Stock	******	******	******	******
Debtors	******	******	******	******
Shot term/Temporary/Marketable Investments	******	******	******	******
Prepaid Expenses	******	******	******	******
Accrued Income	******	******	******	******
Short-term Loans and Advances	******	******	******	******
Total Current Assets (A)	******	******		
Current Liabilities				
Sundry Creditors	******	******	******	******
Bills Payable	******	******	******	******
Provision for Taxation	******	******	******	******
Bank Overdraft	******	******	******	******
Short-term Loans or Deposits	******	******	******	******
Proposed Dividend	******	******	******	******
Total Current Liabilities (B)	******	******		
Working Capital (A) - (B)	******	******	******	******
Net Increase or Decrease in Working Capital	******	******	******	******
Total	******	******	******	******

Fund flow statement format

To prepare a funds flow statement, you have to follow the below steps:

1. Prepare a Schedule of Changes in Working Capital. ...
2. Prepare the Adjusted P&L Account to find out Funds from Operations. ...
3. To create the fund flow statement; you need to identify the Sources of Funds (Inflows) and Application of Funds (Outflows)

Sources of Funds		**Application of Funds**	
Capital Funds	xxx	Funds utilised in Fixed assets.	xxx
Loans and Debts	xxx	Funds utilised in other Non-current assets.	xxx
Operations generated Funds	xxx		xxx
Sale of assets (if any)	xxx	Funds used for repaying loans existing.	
*(Bal fig) Excess of sources minus funds used.		Funds used for paying taxes, dividends, etc.	**xxx**
		*(Bal fig) Funds minus the application of funds shortage.	
[**Working capital Decrease**]		**[Working capital increase]**	
Total	**Xxx**		**xxx**

- **Adjusted profit and loss account**