



FUNDS FLOW ANALYSIS: A THEORETICAL DISCUSSION

[Introductory Class, First Part]

Subject: Financial Reporting & financial Statement Analysis

Class: B.Com. Semester 6. Hons. & Genl.

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Concept of Funds Flow Statement

A Fund Flow Statement is a statement which gives us a detailed and analytical information about the flows in and flows out of fund or about the different sources of application of fund during a certain period , or during an accounting year.

Objectives of preparing Funds Flow Statement:

- Point out the major items affecting the sources and application of funds relating to fixed assets, long-term liabilities, capital etc.
- The statement informs how prudently, efficiently and effectively the resources derived and earned during the normal activities of the business have been put to use again.
- It helps us to know the exact amount of fund collected by sale of fixed assets.
- The statement also shows the exact amount of funds earned from normal business activities of the enterprise.
- It informs us about the amount of fund collected from the issue of shares, issue of debentures and other long term loans.
- It also shows the amount of fund utilised for the purpose of acquisition of fixed assets and repayment of loans and other long term loans, payment of dividend and repayment of short-term loans.
- The statement helps the management to formulate future policies and to prepare the capital and other budgets.

Importance of Funds Flow Statement:

- **Working Capital:** A true picture of changes in working capital of a concern between two Balance Sheet period can be available from this statement.
- **Use of Capital:** The various sources, applications and the latest position of the working capital can be clearly known.
- **Financial planning:** Future financial plan of the concern can be derived from the statement.
- **Allocation of resources:** It helps to proper allocation of various resources and effective use of them.
- **Issue of Shares and Debentures:** The details relating to issue of shares and debentures and the effect in raising of capital are reflected from this statement.
- **Net Profit:** The amount of net profit use and its purpose can be easily known .
- **Dividend:** The statement shows whether proper amount of dividend has been declared and paid or not.
- **Repayment of loan:** Information regarding repayment of loans can be available from a Funds Flow Statement.

Limitations of Funds Flow Statement

- **Not a basic or primary statement:** It is only a secondary statement prepared with the help of income statement or position statement.
- **Statement of historical cost only:** It is an analytical statement of the past cost or historical costs. It cannot analysis any future financial plan.
- **Interim statement:** The funds flow statement always shows the flow of funds or change of capital in between two position statement.
- **Dependence:** The statement depends on the income statement and position statement of the concern.
- **Importance:** A funds flow statement is unable to furnish any information regarding any change of cash position of the business.
- **Not a substitute:** It is only an analytical statement. It analyses the information supplied by the position statement and income statement. It can not give any more new information. So, it is not a substitute for those basic statements.

Distinction Between Balance Sheet and Funds Flow Statement

<u>Funds flow statement</u>	<u>Balance Sheet</u>
1. It shows the working capital changes between two balance sheet dates.	1. It shows the assets and liabilities position of the company on a particular date.
2. It shows the changes in the financial position of the company and dynamic in nature.	2. It is a statement of financial position of the company on a particular date and static in nature.
3. It does not deal with the personal accounts of the business.	3. The balance sheet contains the details of personal account also.
4. It shows the sources and uses of funds in a particular period of time.	4. It discloses the value of assets and liabilities at a particular point of time.
5. The flow of funds over a period of time is known from the funds flow statement.	5. The flow of funds cannot be find ' out on seeing balance sheet.
6. It is tool for financial analysis to the top management.	6. Balance sheet cannot be used as a tool for financial analysis to the top management.
7. A schedule of changes in working capital is prepared before preparing funds flow statement.	7. Profit and loss account is prepared before preparing balance sheet.
8. Funds flow statement is prepared whenever a need raised to the top management.	8. Balance sheet is prepared at the end of the accounting period.
9. Funds flow statement is not published.	9. Balance sheet is published.
10. Funds flow statement is used mostly by the top management.	10. Balance sheet is normally used by external parties.
11. Balance sheet is used to prepare funds flow statement.	11. Funds flow statement cannot be used for preparing balance sheet.
12. The information of balance sheet are used for preparing funds flow statement.	12. The information of trial balance are used for preparing balance sheet.
13. It is prepared only after the financial accounts are completed.	13. It is prepared soon after preparing profit and loss account.
14. Funds flow statement is prepared by the Management Accountant.	14. Balance Sheet is prepared by the Chartered Accountant

Differences Between Income Statement and Funds Flow statement


Funds Flow statement	Income Statement
1. Funds flow statements main objective is to ascertain the funds generated from operations. It reveals the sources of funds and their applications.	1. Main objective is to net profit earned or loss incurred at end of a financial period.
2. Funds flow statement is prepared based on the financial statements of two consecutive years.	2. Income statement is prepared on the basis of nominal accounts of particular accounting period.
3. Funds flow statement takes into account not only the funds available from trading operations but also funds available from other sources like issue of share capital/debentures, sale of fixed assets etc.	3. Uses only transactions are relating to income and expenditures for a particular period.
4. Preparation of funds flow statement is not a statutory obligations and is left to the discretion of management.	4. Preparation of Profit & Loss account is a statutory obligation.
5. Income statement is one of the source documents in preparation of funds flow statement.	5. Can be prepared without the help of Funds Flow statement.
6. Funds flow statement may be prepared much before business operations and act as an instrument of planning and control.	6. 6. Income statement is static inasmuch as it gives information on what has happened during the period covered by it.
7. Funds flow statement can be prepared as and when management wants it.	7. Income statement is prepared only at the end of accounting period for the period covered by it.
8. Funds flow statement provides a complete record of transactions involving cash.	8. Income statement is prepared on accrual basis of accounting and fails to present the factual history of firm's cash transactions.
9. Funds flow statement cannot be easily manipulated by management.	9. The determination of periodic income is necessarily based on number of estimates, judgment and allocations and is subject to manipulations of management.

Distinction Between Net Profit and Funds From Operations

Net Profit	Funds from Operations
1. Differences between revenues and expenses	1. Change in working capital resulting from operations
2. Ascertained from Profit and Loss Account	2. Ascertained by preparing a statement
3. Not concerned with flow of funds	3. concerned with flow of funds
4. Funds from operation is not the basis for ascertaining net profit	4. Net profit is the basis for ascertaining funds from operations.
5. Difference between the income and expenses on accrual basis.	5. Difference between inflow of funds (revenue) and out flow of funds (expenses).
6. It is a part of the Balance Sheet	6. It is a part of the sources of funds.

Distinction Between Funds Flow Statement and Schedule of Changes in Working Capital

Funds Flow Statement	Schedule of Changes in Working Capital
1. Shows the sources and applications of funds	1. Shows the changes in individual items of current assets and current liabilities.
2. Concerned with the current and non-current assets and liabilities	2. Concerned with current assets and current liabilities
3. It is not apart of Schedule of Changes in Working Capital	3. It is a part of the Funds Flow Statement
4. Prepare from Profit and Loss account and two consecutive Balance Sheets.	4. It is prepared from two consecutive Balance Sheets



**FOR THE PREPARATION
OF
FUNDS FLOW STATEMENT
YOU ARE REQUESTED TO
PLEASE SEE THE**

**INTRODUCTORY CLASS,
SECOND PART
ON**

FUNDS FLOW ANALYSIS