



Study Notes

Funds Flow Statement

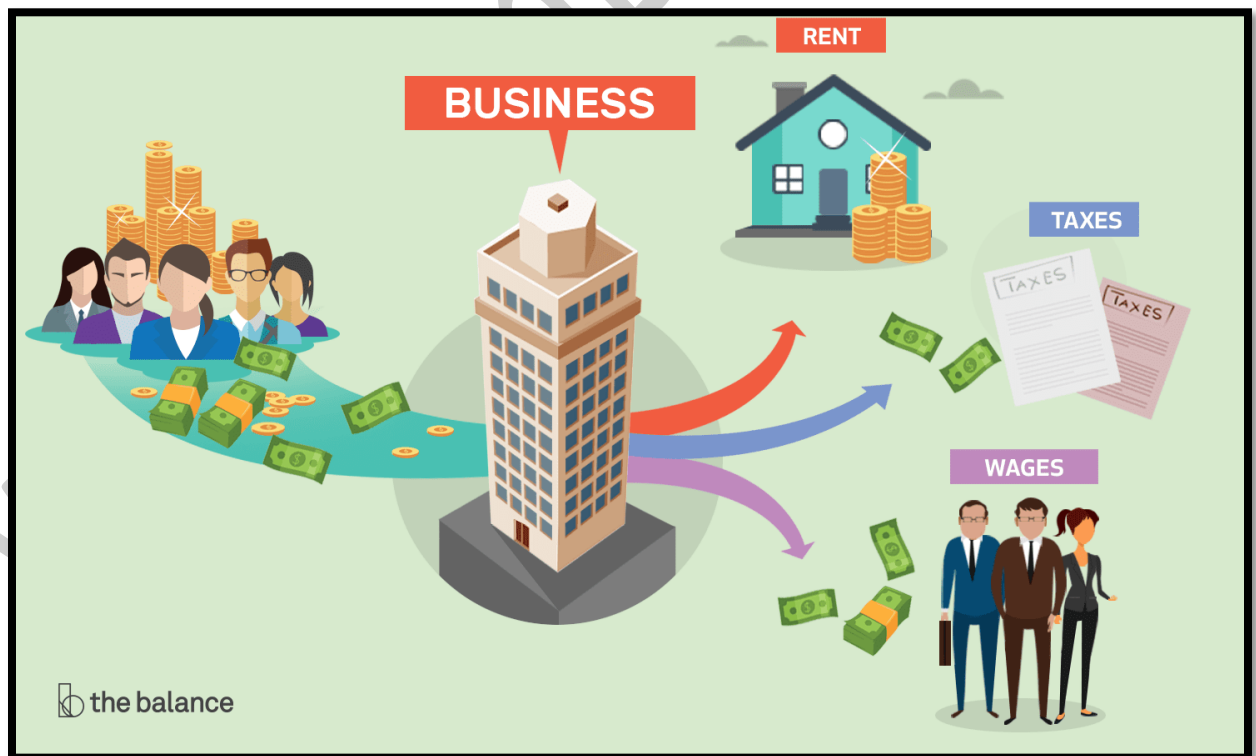
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Introduction

- Funds Flow Statement is a statement prepared to determine the sources and uses of working capital between 2 balance sheet dates.
- Working Capital = Current Assets – Current Liabilities
- The concept of Working Capital is used prominently to determine the liquidity position of the firm.
- Funds Flow Statement holds a lot of importance because through it, the management anticipates the WC flows in order to plan the repayment of its long term debt and does other decision making. Similarly, for growth and expansion, a firm needs larger amount of WC and therefore, estimates of WC is required to determine the adequacy of enough liquidity in conformity with the decisions.

Concept of Working Capital Flow

- WC flow arises when the net effect of a transaction is to increase/ decrease the amount of Working Capital.
- In a business transaction, one of the two effects would take place:
 - Changes in Working Capital
 - No Change in Working Capital



- **Example: Issue of Ordinary Shares for Cash**
It leads to the following effects:
 - Increase in Cash (Current Assets)

- Increase in Share Capital

Net Effect – Increase in Working Capital

- **Example: Purchased Machinery for Cash**

It leads to the following effects:

- Decrease in Cash (Current Assets)
- Increase in Non-Current Asset (Machinery)

Net Effect – Decrease in Working Capital



- **Example: Receive Cash from Debtors**

It leads to the following effects:

- Increase in Cash (Current Assets)
- Decrease in Debtors

Net Effect – No change in Working Capital, although the composition of Working Capital would change

- **Example: Payment of Cash to Creditors**

It leads to the following effects:

- Decrease in Cash (Current Assets)
- Decrease in Creditors (Current Liabilities)

Net Effect – No Change in Working Capital, although the composition of Working Capital would change

- **Example: land purchased by issuing Shares**

It leads to the following effects:

- Increase in Share Capital
- Increase in Non-Current Assets (Land)

Net Effect – No Change in Working Capital

- **Example: Converting Debentures into Equity**

It leads to the following effects:

- Decrease in Debentures
- Increase in Equity

Net Effect – No Change in Working Capital



- **Under Profit & Loss A/c, Revenue will lead to one of the following effects:**
 - Increase in Cash, or
 - Increase in Accounts Receivables

Net Effect – Increase in Working Capital

- **Under Profit & Loss A/c, Expenses will lead to one of the following effects:**
 - Decrease in Cash, or
 - Increase in Outstanding Liabilities

Net Effect – Decrease in Working Capital

- **Certain items in Profit & Loss A/c that have no effect on Working Capital**
 - Depreciation, that will lead to the following effects:
 - Decrease in Non-Current Assets
 - Increase in Depreciation Expense

Net Effect – No Change in Working Capital

Conclusion for Change in Working Capital

Net WC will increase or decrease when a transaction involve one Current Aspect and one Non-Current Aspect (Eg. Machinery purchased using Cash)

Net WC will remain unaffected when a transaction involves both Current Aspects (Eg. Cash received from Debtors)

Net WC will remain unaffected when a transaction involves both Non-Current Aspects (Eg. Converting Debentures into Equity)

Sources of Working Capital

1. Funds from Operations

In arriving at profit, there are certain Non-Cash transaction as well, therefore these profits from operations needs to be adjusted for calculating this as a source of working capital.

2. Sale of Non-Current Assets

It can be one among the following

- Sale of Long-term Investments
- Sale of tangible Fixed Assets
- Sale of Intangible Fixed Assets

3. Issuance of Long-Term Finance

It can be one among the following

- Taking Long-term borrowing
- Issuance of Equity or Preference Shares

4. Raising Short term finance

It can be one among the following

- Bank -Borrowing
- Any other short-term finance

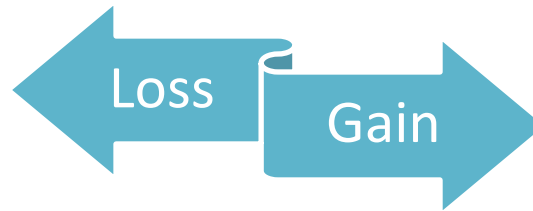
Funds from Operations – Adjusted net income from operations



- Profit and Loss Account contains certain items that do not affect Working Capital, therefore, the figure of Net profit from Profit & Loss Account needs to be adjusted
- Most of the expenses in the Profit & Loss Account either reduces the Current Asset through outflow of Cash or increases the Current Liability by booking creditors or outstanding expenditure.
- One item in the Profit & Loss Account is depreciation which doesn't affect Working Capital but it decreases the amount of net profit. It also reduces the Fixed Asset without affecting Cash. Because of this combination of Accounts, it doesn't affect Working Capital. Therefore, in order to arrive at the adjusted net income, it needs to be added, otherwise the net profit would be understated.
- Similarly, the goodwill written off and amortization needs to be added back.

Gain or Loss from Sale of Non-Current Asset

- Loss is added to the Net Profit
- Gain is subtracted from the Net Profit



- This addition and deduction respectively of loss and gain happens because all the inflows from the sale of Non-Current Asset is listed separately as a source of Working Capital

Funds Flow Statement

There are two presentations of making the Funds Flow Statement:

1. Preparation of Statement of Changes in Working Capital

Under this, we list the sources and uses of Working Capital

Sources of Working Capital
Funds from Operations
Sale of Non-Current Assets
Issuance of Long-term borrowings and Share Capital
Taking Short-term Borrowings

Uses of Working Capital
Purchase of Long-term Investments
Payment of Long-term Loans
Payment of Cash Dividends

Net Balancing Figure would be net increase or decrease in the Working -Capital

2. Schedule of Changes in Working Capital

Under this, we start with Opening Working Capital and compares it with the Closing Working Capital to see the increase or decrease in the amount of Working Capital

Example of Preparation of Funds Flow Statement

Question:

Comparative Balance Sheets as on 31st December 2010 and 31st December 2011 along with the Profit & Loss Account for the year ending 31st December 2011 for XYZ Ltd. is given. Additional Information is also given as follows:

Income Statement for the year ending 31 December 2011	
Particulars	Amount
Sales	500000
COGS	-210000
Gross Profit	290000
Office & Admin	-45000
Selling & Distribution	-25000
Interest	-12000
Depreciation	-22000
Gain on Sale of Plant	6000
PBT	192000
Tax	-87000
Net Profit	105000

	31-Dec-11	31-Dec-10	Changes
Current Assets			
Cash	70000	50000	20000
Debtors	40000	45000	-5000
Inventory	125000	90000	35000
	235000	185000	50000
Non-Current Assets			
Land & Building	150000	100000	50000
Plant & Machinery	220000	200000	20000
Less: Accumulated-Depreciation	-82000	-80000	-2000
	288000	220000	68000
Total Assets	523000	405000	118000

	31-Dec-11	31-Dec-10	Changes
Current Liabilities			
Creditors	25000	30000	-5000
Salaries Payable	15000	10000	5000
Provision for tax	50000	60000	-10000
Other Current Liability	40000	40000	0
Non-Current Liabilities			

Institutional Loan	23000	15000	8000
Debentures	120000	150000	-30000
Share Equity			
Share Capital	175000	75000	100000
Securities Premium	12500	7500	5000
Reserves & Surplus	62500	17500	45000
Total Funds	523000	405000	118000

Additional Information

1. During the year, a plant costing 50000 (accumulated depreciation 20000) was sold
2. Debentures of 30000 were converted into Share Capital at par
3. The company declared a Cash dividend of 40000 and bonus shares of 20000 has been distributed during the year
4. Company issued 5000 additional shares, having a par value of 10 at a premium of 1 per share during the year

Calculate the Net Effect on Working Capital through preparation of Funds Flow Statement!

Answer

Preparation of Funds Flow Statement

Funds Flow Statement	
Particulars	Amount
Sources of Working capital	
Working Capital from Operations	121000
Sale of Plant	36000
Institutional Loan	8000
Issuance of Ordinary Shares	55000
Funds Provided	220000
Uses of Working Capital	
Purchase of Land & Building	50000
Purchase of Plant & Machinery	70000
Payment of Cash Dividends	40000
Funds Applied	160000
Increase in Working Capital	60000

Or

Schedule of Changes in Working Capital			
	31-Dec-11	31-Dec-10	Changes
Current Assets			
Cash	70000	50000	20000
Debtors	40000	45000	-5000
Inventory	125000	90000	35000
	235000	185000	50000

Schedule of Changes in Working Capital			
	31-Dec-11	31-Dec-10	Changes
Current Liabilities			
Creditors	25000	30000	-5000
Salaries Payable	15000	10000	5000
Provision for tax	50000	60000	-10000
Other Current Liability	40000	40000	0
	130000	140000	-10000
Net Changes in Working Capital			60000

Workings

1. Working Capital from Operations

Particulars	Amount
Net Profit	105000
Add: Depreciation	22000
	127000
Less: Gain on Sale of plant	-6000
Working Capital from Operations	121000

2. Sale of Non-Current Asset (Plant)

Particulars	Amount
Original Cost	50000
Less: Accumulated-Depreciation	-20000
Book Value	30000
Gain on Sale of Plant	6000
Sale Value of Plant	36000

3. Increase in Institutional Loan

Particulars	Amount
31 December 2011 Loan	23000
Less: 31 December 2010 Loan	-15000
Additional Loan Amount	8000

4. Issuance of Shares

Particulars	Amount
31 December 2011 Share Capital	187500
Less: 31 December 2010 Share Capital	-82500
Net Addition	105000
Less: Bonus Shares	-20000
Less: Convertible Debentures into Equity	-30000
Net Additional Proceeds through Share Capital	55000

5. Purchase of Plant & Machinery = 70000

Plant & Machinery Account

Particulars	Amount	Particulars	Amount
To Bal B/d	200000	By Sale	50000
To Purchase (Bal Fig)	70000	By Bal C/d	220000
	<u>270000</u>		<u>270000</u>

6. Purchase of Land & Building

Particulars	Amount
31 December 2011 Land & Building	150000
Less: 31 December 2010 Land & Building	-100000
Net Addition	50000

7. Payment of Cash Dividends = 40000