UNIT 6 STATEMENT OF CHANGES IN FINANCIAL POSITION

Structure

6.0 OBJECTIVES

The objectives of this unit are to:

- explain need for funds flow statement for investors and other stockholders in addition to balance sheet and profit and loss account;
- compare the differences between funds flow statement with other financial statements;
- familiar with the concept of funds;
- explain the methodology for preparation of funds flow statement under different methods; and
- explain how funds flow statement can be used in real life for different decision making.

6.1 INTRODUCTION

As a student of accounting, you are aware of basic difference between Profit and Loss Account and Balance Sheet on time scale. While Profit and Loss Account is prepared for a period, Balance Sheet presents financial position at a particular point of time. Is there any way for users to convert the Balance Sheet into a flow statement? If the answer is yes, what is the use of such conversion? Let us take the second issue to understand the concept. Balance Sheet shows the sources of capital or funds for the assets that the firm holds or how the firm spent its capital or funds on various assets. This is an important useful information to the users of financial statements but it fails to tell how much of assets have been added during the period and how such additional investments are funded. In other words, the users would like to know whether the firm is growing or not and if it is growing, what is the source of capital or funds. Users would also like to know whether there is any change in the pattern of funding over the years. Therefore, there is a need for converting the point statement into flow statement. So, the next question is how to convert the Balance Sheet into Funds Flow Statement. There are different levels at which one can achieve the translation and the easiest and crude way is to find the differences in the values of each Balance Sheet item.

To illustrate the idea of funds flow statement and also to get a quick idea on the concept, let us have a look on the summary of Balance Sheet items of Ranbaxy Laboratories Ltd., which is one of the largest players in the pharmaceutical industry in India. The details are as follows:

Summary of Balance Sheet values of Ranbaxy Laboratories Ltd.

(*Rs. in Crores*)

Year	**2002**	**2001**	**2000**	**1999**	**1998**
Share Capital	185.45	115.90	115.90	115.90	115.90
Reserves & Surplus	1686.06	1486.30	1466.76	1382.04	1284.94
Loans	6.90	125.98	255.81	322.88	424.93
Current Liabilities and Provision	935.37	586.67	417.98	308.71	307.49
Total	**2813.78**	**2314.85**	**2256.45**	**2129.53**	**2133.26**
Fixed Assets	675.39	613.05	644.37	631.90	613.56
Investments	337.50	342.52	290.03	282.77	332.47
Current Assets, Loans & Advances	1800.89	1359.28	1322.05	1214.86	1187.23
Total	**2813.78**	**2314.85**	**2256.45**	**2129.53**	**2133.26**

The above Balance Sheet values show how the values have changed (increased or decreased) over the years. It also tells how the assets are funded over the years. The following table shows the Balance Sheets values in percentage format.

Summary of Balance Sheet values of Ranbaxy Laboratories Ltd. (in %)

(Rs. in Crores)

Year	**2002**	**2001**	**2000**	**1999**	**1998**
Share Capital	7%	5%	5%	5%	5%
Reserves & Surplus	60%	64%	65%	65%	60%
Loans	0%	5%	11%	15%	20%
Current Liabilities and Provision	33%	25%	19%	14%	14%
Total	**100%**	**100%**	**100%**	**100%**	**100%**
Fixed Assets	24%	26%	29%	30%	29%
Investments	12%	15%	13%	13%	16%
Current Assets, Loans & Advances	64%	59%	59%	57%	56%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

The picture is somewhat clear now but not complete. Ranbaxy, which used to have about 20% of total funds through loans is now not raising any debt to fund its assets. The company has turned almost zero-debt company over the period of 5 years. This decline is suitably compensated through an increase in current liabilities. There is also an increase in current assets values over the years. While these details are useful, the percentage analysis fails to show any movement of funds in absolute value. Let us now simply take the difference of the values and see how the picture looks over the years.

Summary of Changes in Balance Sheet values of Ranbaxy Laboratories Ltd.

(Rs. in Crores)

Year	**2002**	**2001**	**2000**	**1999**
Share Capital	69.55	0.00	0.00	0.00
Reserves & Surplus	199.76	19.54	84.72	97.10
Loans	–119.08	–129.83	–67.07	–102.05
Current Liabilities and Provision	348.70	168.69	109.27	1.22
Total	**498.93**	**58.40**	**126.92**	**-3.73**
Fixed Assets	62.34	– 31.32	12.47	18.34
Investments	–5.02	52.49	7.26	–49.70
Current Assets, Loans & Advances	441.61	37.23	107.19	27.63
Total	**498.93**	**58.40**	**126.92**	**– 3.73**

The above table gives better picture. Over the years, Ranbaxy invested heavily on current assets, loans and advances. The source of funds to meet this huge increase in investments is primarily current liabilities and also from funds from operation. The company reduced its loans value over a period of time by repaying loans. Once you have this information, it is possible for you to examine how Ranbaxy is comparable with other companies in the industries. For instance, if you find some of the pharmaceutical companies are expanding faster than Ranbaxy, then as an investor, you will worry about the future of the company. It is possible to perform such analysis using funds flow statement. The funds flow statement, which we have prepared above is bit crude and we need to make some adjustments to prepare a good funds flow statement. This will dealt with in subsequent sections.

Activity 1

1) Refer Ranbaxy Laboratories Ltd. Balance Sheet. Prepare a statement to show how the funds have moved from the year 1998 to 2002. Ignore the funds flow of in between years i.e., assume Ranbaxy has not prepared any balance sheet for in between years.

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2) List down major sources and uses of funds in descending order.

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3) Draw a broad conclusions on the flow of funds during this period.

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6.2 NEED FOR CHANGES IN FINANCIAL POSITION

Accounting Standard (Revised) - 3 has made funds flow statement redundant and prescribed cash flow statement. Despite that why do we feel funds flow statement is useful to users of accounts? Funds flow statement provides some further insight into the Balance Sheet and particularly shows how the firm is able to get money to take up several activities. It is possible to know what is the kind of funds mix that the firm is using particularly a comparison of internal and external funds. For instance, Ranbaxy heavily uses internal funds and depend little on external funds. In contrast, Aurobindo Pharma Ltd. another major player in the pharmaceutical industry uses debt substantially for the funding its activities.

Summary of Changes in Balance Sheet values of Aurobindo Pharma Ltd.

(Rs. in Crore)

	2002-03	2001-03	2000-03	1999-03
Share Capital	0.67	1.00	0.55	13.23
Reserves & Surplus	84.27	55.71	94.43	41.45
Debt	110.10	84.99	29.95	40.10
Total	**195.04**	**141.70**	**124.93**	**94.78**

Funds flow statement can also be used to know how the resources raised are used. For instance, we observed Ranbaxy spends most of the resources for increasing current assets. Aurobindo Pharma also uses substantial part of the funds for increasing current assets and it looks like that there is something which is driving for the industry to build up more current assets. A further analysis shows that a significant part of the currents assets are funding of receivables without corresponding increase in sales. Though balance sheet also highlights an increase in receivables values, it is not apparent that substantial part of the funds raised during the period go for funding of such receivables.

It is possible to examine how healthy the financial policies of firms. For instance, many firms would like to avoid using short-term capital for long-term purposes. It is possible to identify whether firms in which you are interested use funds in a sub-optimal way.

Activity 2

1) Pick up annual report of two or three companies belonging to software or any other industry. Compare the changes in balance sheet values for two years and write down the values here.

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2) Write a brief on the sources of funds and where they are used. Also, compare these figures between the companies and write down your views.

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3) Do you find all the companies are behaving in a same way? Mostly it will not be and if so, why do you feel companies follow different strategies in raising funds and using the same in different assets?

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6.3 STATEMENT OF CHANGES IN FINANCIAL POSITION—MEANING

Statement of changes in financial position is a statement which outlines the causes of a change in the financial position of a company during an accounting period. These causes are reflected in the movement of funds viz., inflows and outflows of funds during the period. Therefore, it is called Funds Flow Statement in which the inflows are shown as sources of funds and the out flows are shown as application or uses of funds. The difference between the two (inflows and outflows) indicates the net changes (increase or decrease) in the position of funds during the accounting period.

6.4 CONCEPT OF FUNDS

The Balance Sheet gives a ‘snapshot’ view at a point in time for the sources from which a firm has acquired its funds and the uses, which the firm has made of these funds. The flow statement explains the changes that took place in the Balance Sheet account. Firms get funds from various sources. Broadly, we classify the sources of funds into two categories namely, long-term funds and short-term funds, Sources of long-term funds include equity share capital, funds provided by operation, term loan, etc. Source of short-term funds consists of supplier credit and any short-term borrowing. The term fund is broader compared to the term cash. For instance, when a firm sells goods on credit, there is no cash flow and cash flow statement ignores such transactions. On the other hand, funds flow statement treats this source of funds from operating activities and treat the increased accounts receivables as application of funds for working capital purpose. On the other hand, if the firm collects receivables of last year, it appears in cash flow statement, whereas it has no impact in funds flow statement because there is no change in working capital. That is, while receivables decline its value, cash increases to that extent and flow of funds is restricted within the working capital group. The concept of funds simply denotes whether there is any change in Balance Sheet item at aggregate level and such changes lead to an increase in fund or decrease in fund. The following are certain activities, which will not affect fund flow statement and any effect that arises out of these activities will be restricted to working capital statement.

a) Collection of bills receivable.

b) Payment of bills payable.

c) Purchase of Materials for cash or on credit basis.

d) Sale of goods on cash or credit basis (except for the profit or loss component).

The above items normally affect cash flow statement [cash part of item (c) and (d)]. There are several items, which affects funds flow and not cash flow statement. A few of them are:

a) Sale or purchase of goods on credit basis – it affects funds from operation and to a minor extent working capital statement.

b) Purchase of fixed assets on credit basis.

c) Expenses incurred but not paid.

d) Income accured but not received.

e) Changes in value of closing stock.

There are several items, which affect both funds flow and cash flow statement. A few of them are:

a) Fresh Equity

b) Fresh loan or repayment of loan

c) Purchase of fixed assets by paying cash

d) Cash sales and purchases

e) Cash Expenses

From the above discussion, it is clear that 'funds' in funds flow statement means changes in equity, liability or working capital. It includes both cash and non-cash items. In this unit, for the purpose of funds flow statement, we use the net working capital concept which refers to excess of current assets over current liabilities.

Activity 4

1) A machine costing Rs. 70,000 (book value Rs. 40,000) was sold for Rs. 25,000. What is the impact of this transaction on funds flow statement?

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2) The book value of Inventory was Rs. 8 lakhs and market value is Rs. 6.50 lakhs. What is the effect of change in market value on funds flow statement?

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3) Finished goods worth of Rs. 3 lakhs was sold for Rs. 3.50 lakhs on cash. What is the impact of this transaction on funds flow statement? Suppose if the above sale is on credit basis, will it have different impact? Explain.

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4) What do you understand the term 'fund' in the context of funds flow statement?

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5) Categorise the following items under current and non-current assets and liabilities.

   i) Bank Balance ....

   ii) Goodwill ....

   iii) Income received in advance ....

   iv) Share premium ....

6.5 FLOW OF FUNDS

Flow of funds means 'change in fund position' or 'change in net working capital'. Whenever there is a change in the funds, it is presumed that flow of funds has taken place. The flow of funds can be in the form of a inflow or an outflow. An inflow of funds increases the working capital and an outflow of funds decreases the working capital.

Flow of funds will takes place if a transaction involves a change in a current item and change in a non-current item. A non-current item means either a non-current asset (Fixed asset) or a non-current liability (long-term liability). There will be no change in net working capital (flow of funds) if a transaction involves : (i) only the current items or (ii) only the non-current items. In other words, a transaction, involving a fixed asset/fixed liability on the one hand and a current asset/current liability on the other, will alone result in flow of funds. Let us understand these rules by taking up some examples.

1) **Transactions involving items from both current and non-current categories which result in flow of funds:**

   i) **Purchased machinery for Rs. 30,000 :** This transaction increases machinery (a non-current asset) and reduces cash (a current assets). The reduction in cash reduces current assets without any corresponding reduction in current liabilities. As a results, the net working capital gets reduced.

   ii) **Shares issued for Rs. 2,00,000 :** In this case, a non-current liability (i.e., share capital) has increased and a current asset (i.e., cash) has increased. Thus the current asset has increased without any corresponding change in current liabilities. As a result, net working capital gets increased.

2) **Transactions affecting items in the current category only which do not result in flow of funds:**

   i) **Cash collected from debtors Rs. 4000 :** This transaction results in an increase in cash (a current asset) and a decrease in debtors (a current asset, again) by the same amount. Thus the total current assets remain the same and there will be no change in the net working capital.

   ii) **Acceptance given to creditors Rs. 3,000 :** Both creditors and bills payable are current liabilities. By giving acceptance to creditors, the amount of creditors decreases and that of bills payable increases by the same amount. Since this transaction does not affect the total amount of current assets as also the total amount of current liabilities, the difference between current assets and current liabilities remains unchanged. Thus, there is no flow of funds and no change in the net working capital.

   iii) **Paid creditors Rs. 1,000 :** By paying the creditors cash (a current asset) is reduced and the amount of creditors (a current liability) is also reduced by the same amount. Therefore, the difference between the current assets and current liabilities will be the same as it was before. So there will be no flow of funds, which means no change in the net working capital.

3) **Transactions affecting items in the non-current category only which do not result in flow of funds:**

   i) **Land exchanged for machinery Rs. 10,00,000 :** Both land and machinery are non-current assets. By exchanging land for machinery, the book value of land is reduced and that of machinery is increased, but the total of non- current assets remains unaffected. Further, it does not effect any change in the current assets or the current liabilities. Hence, there will be no change in the net working capital position.

   ii) **Preference shares are converted into equity shares Rs. 10,00,000 :** Both preference share capital and equity share capital are non-current items. As a result of conversion, the equity share capital stands increased and the preference share capital gets reduced by the same amount. As no current item is affected, there will be no change in net working capital.

   iii) **Purchased land worth Rs. 50,000 and issued shares in consideration thereof :** This transaction increases the debit balance of the land account and credit balance of share capital account Both land and share capital are non- current items. Since no current items is involved, the net working capital remains unaffected.

We can summarise the above analysis as follows :

1) There will be flow of funds if transaction involves:

   i) Current assets and non-current liabilities:

   ii) Current assets and non-current assets.

   iii) Current liabilities and non-current assets.

2) There will be no flow of funds if a transaction involves :

   i) Non-current assets and non-current liabilities.

   ii) Current assets and current liabilities.

For easy reference, the list of non-current and current items is given below :

Non Current Liabilities	Non-Current Assets
Equity Share capital	Goodwill
Preference Share Capital	Plant and Machinery
Debentures	Furniture
Share Premium	Trade Marks, Patnets, Copyrights
Forfeited Shares	Land and Buildings
Current Liabilities	**Current Assets**
Bank Overdraft	Stock
Bills Payable	Debtors
Creditors	Bills Receivable
Outstanding Expenses	Income Outstanding
Incomes received in advance	Cash at bank
	Cash in hand

In order to know whether a transaction brings a change in working capital, it is better to journalise the transaction and then classify the accounts of the transaction to which account it belongs. If both the accounts of the transaction belong to current category or non-current category, there will be no change in working capital. On the otherhand if one account of transaction belongs to current item and the other to non-current item, then there will be a change in working capital.

6.6 SOURCES AND USES OF FUNDS

You have learnt that, funds represent that portion of current assets which is not financed by current liabilities but is financed from the long-term/non-current sources. You have also learnt that as and when a change takes place in current items resulting from a change in non-current items the net working capital will be affected. The increase and decrease in only non-current (long-term) assets and liabilities alone will act as a source or an application (use) of funds. For the preparation of funds flow statement it is necessary to find out the sources and application of funds. Let us now identify the sources and application of funds.

Sources of Funds : The sources of funds can be classified as external sources and internal sources. **External sources of funds refer** to sources of funds from outside the business. These are : (a) raising additional capital, (b) increasing long-term borrowings, and (c) sale of fixed assets and long term investments. **Internal sources** consist of funds that are generated internally by the organisation. Every profitable sale brings in funds to the extent of the excess of sales revenue over cost of goods sold. Such profits, called funds from operation, are also an important internal sources of funds.

Application of funds : It may be noted that all funds raised through long term source are not necessarily applied for financing the increase in net working capital. A substantial part of this amount may be utilized for purchasing the fixed assets, redemption of debentures or preference shares, payment of dividends and meeting losses from operations, if any. In fact whatever is left the application of funds for these purposes, will be the amount used for financing the increase in working capital. Uses of funds thus are: (i) purchase of fixed assets or long term investments, (ii) redemption of debentures and preference shares, (iii) repayment of long term loans, (iv) payment of dividends (v) meeting losses from operations (net loss), and (vi) financing the increase in working capital.

6.7 STATEMENT OF CHANGES IN FINANCIAL POSITIONS – CASH BASIS

There are two versions of the statement of changes in financial position. The first version is called cash basis and the second one is called working-capital basis. The cash basis of changes in financial position is to an extent close to cash flow statement though it is presented in a different manner. This statement first takes revenue and then removes all non-cash revenues and all cash related revenues which are not recognised in computing revenues. In other words, at this stage, we are interested to find out how much of cash is generated under revenue head without bothering whether such revenue pertains to current year, previous year or next year. Similarly, we consider expenses and then remove all non-cash expenses and consider all cash expenses of previous period as well as next period but not considered under the expenses value. For example, if there is a payment for outstanding liability of previous year, it is also considered. The difference of these two is funds or cash from operating activities. Next, cash received from other sources are considered. In the last step, uses of cash for capital transactions are considered to find out the net difference between the sources and uses. The net difference shall be equal to net changes in cash.

The main limitation or shortcoming of this method is its failure to segregate current year income/expenses with other period income/expenses. Our next statement overcomes this issue.

6.8 STATEMENT OF CHANGES IN FINANCIAL POSITIONS–WORKING CAPITAL BASIS

As stated earlier, our main funds flow statement excludes all past and future items and follows accrual and matching principle. Any such outstanding expenses or prepaid expenses or income received in advance, etc. are adjusted in a separate statement called working capital statement. Funds flow statement under this method is prepared in two stages. The following diagram illustrates the concept.

Assets	Liabilities + Equity
Fixed Assets	**Permanent Capital** Share Capital + Reserves Long-Term Loan

Current Assets	Current Liabilities

Funds derived from permanent capital are reduced by funds used for fixed assets acquisition. The balance is the amount available for working capital purpose. The working capital statement shows the difference between the current assets and current liabilities. Thus the above format clearly brings out how much of long-term funds are used for working capital or how much of short-term working capital is used for long-term purpose.

In this unit our funds flow analysis is based on working capital concept which you will study in detail under 6.9 Funds Flow Statement of present unit.

Activity 5

1) Refer the two sets of Changes in Financial Positions statements. Briefly write important differences between the two statements.

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2. Briefly write your understanding under each of the two formats which one you feel is useful in your analysis.

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3. List down atleast three financial transactions that leads to differences in funds flow from operations.

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6.9 FUNDS FLOW STATEMENT

Fund flow statement is intended to explain the magnitude, direction and the causes of changes in the position of funds (net working capital) that took place during the two balance sheets dates. Thus, it highlights the basic changes in the financial structure, asset structure and the liquidity position of a business between two balance sheet dates. But primarily, it reveals changes in the financial position of the company by identifying the sources and application of funds resulting from financing and investing decisions that took place during a particular period.

The preparation of fund flow statement involves essentially the following three steps:

1) Schedule of Changes in Working Capital.

2) Statement of Funds from Operations.

3) Preparation of the Funds Flow Statement (on working capital basis).

6.9.1 Schedule of Changes in Working Capital

As explained earlier, the first step in the preparation of fund flow statement is to prepare the schedule of changes in working capital. For this purpose, all non-current items are to be ignored as the net working capital is simply the difference between current assets and current liabilities.

In order to ascertain the amount of increase or decrease in the net working capital, it could be noted that:

i) an increase in any current asset, between the two balance sheet dates, results in an increase in net capital and a decrease in any current asset result in a decrease in net working capital; and

ii) an increase in any current liability, between the balance sheet dates, decreases the net working capital whereas a decrease a in any current liability increases the net working capital.

The schedule of changes in working capital may be prepared with the help of the following specimen statement:

Proforma of Schedule of Changes in Working Capital

Particulars	Previous Year Rs.	Current Year Rs.	Changes in Working Capital	
			Increase (Debit) Rs.	Decrease (Credit) Rs.
Current Assets:				
Cash in hand				
Cash at Bank				
Marketable Securities				
Bills Receivable				
Debtors				
Stock				
Prepaid Expenses				
Current Liabilities:				
Creditors				
Bills Payable				
Outstanding Expenses				
Working Capital:				
Increase/Decrease in Working Capital				

Illustration 1

From the following summarised Balance Sheets of ABC Ltd. as on 31st March, 2004 and 2005, prepare a schedule of changes in working capital:

Liabilities	2004 Rs.	2005 Rs.	Assets	2004 Rs.	2005 Rs.
Equity share capital	1,20,000	1,20,000	Fixed assets	90,000	75,000
Preference share capital	—	30,000	Sundry debtors	1,20,000	72,000
General Reserve	6,000	6,000	Closing stock	30,000	1,05,000
Profit and Loss a/c	12,000	16,200	Prepaid expenses	3,900	1,500
Debentures	33,000	38,400	Bank	600	10,500
Conditors	36,000	39,000			
Bank Overdraft	37,500	14,400			
	2,44,500	2,64,000		2,44,500	2,64,000

Solution

Schedule of Changes in Working Capital

	2004 Rs.	2005 Rs.	Changes in working capital Increase (+) Rs.	Decrease (—) Rs.
Current Assets:				
Sundry Debtors	1,20,000	72,000	—	48,000
Closing Stock	30,000	1,05,000	75,000	—
Prepaid Expenses	3,900	1,500	—	2,400
Bank	600	10,500	9,900	
	1,54,500	1,89,000		
Current Liabilities:				
Creditors	36,000	39,000		3,000
Bank Overdraft	37,500	14,400	23,100	
	73,500	53,400		
Working Capital	81,000	1,35,600		
Net increase in working capital	54,600			54,600
	1,35,600	1,35,600	1,08,000	1,08,000

6.9.2 Statement of Funds from Operations

You know that profit is an important source of funds. Profit is the result of revenue over expenses. When a business earns profit the net working capital gets increased to the extent of the profit earned. Therefore, the profit earned constitutes an important element of the funds provided by operations. Certain items charged and revenues earned actually do not involve any flow of funds during the current period. Similarly, certain deferred revenue expenses written off like preliminary expenses, discount on issue of shares etc. do not involve any outflow of funds. Hence, these items are added back to the net profit in order to arrive at the amount of funds from operations. Also there are certain non- operating incomes and expenses like profit or loss on the sale of fixed assets, dividend from investment, etc. are taken into account to arrive at net operating results of the business. The profit or loss arising out of these transactions are not regular operations of business. Hence, the effect of these items must not be taken into account while preparing funds from operations, i.e., the profit on such items are to be excluded from the net profit and loss must be added back to the net profit to ascertain the amount of funds from operations. There are many items which are charged and credited to profit and loss account but do not affect working capital. Hence, all such items need adjustment to calculate funds from operations.

There are two methods to calculate ‘Funds from Operations’ :

1) Statement of Funds from Operations Method.

2) Adjusted Profit and Loss Account Method.

Statement of Funds from Operations Method

Under statement form, all non-funds or non-trading charges which were already debited to Profit and Loss Account are added back to net profit and all non-trading incomes which were already credited to profit and loss account are to be subtracted from the net profit. Funds from operations may be calculated with the help of the following proforma:

Proforma of Statement of Funds from Operations

		Rs.	Rs.
Net Profit (Current year)			xxx
Add: Non-fund and non-trading charges :		. . .	
(Already debited to P & L a/c)			
Depreciation Preliminary expenses		. . .	
Transfer to General Revenue		. . .	
Transfer to Sinking Fund		. . .	
Provision for Taxation			
Proposed dividend		. . .	
Loss on Sale of Fixed assets		. . .	xxxx
		Total	xxxx
Less: Non-fund items and non-trading Incomes:			
(Already credited to P&L a/c)			
Profit on sale of fixed assets		. . .	
Profit on revaluation of fixed assets		. . .	
Non-operating incomes:		. . .	
Dividend received/accrued	. . .		
Refund of Income tax	. . .		
Rent received/accrued, etc.	. . .	. . .	xxx
Funds from Operations			xxxx

Note: In case Profit and Loss Account shows ''Net Loss'', it should be taken as an item which decreases funds and therefore, all the items shown under 'Add' head above should be subtracted and those shown under 'less' head should be added to the 'Net loss'.

Adjusted Profit and Loss Account Method

'Funds from Operations' may also be computed in an 'Account Form' which is as follows:

Proforma of Adjusted Profit and Loss Account

To Depreciation	xx	By Net Profit (previous year)	xxx
To Preliminary expenses (written off)	xx	By Dividend Received	xxx
To General Reserve (Transfer)	xx	By Refund of Tax	xxx
		By Rent Received	xxx
To Sinking fund (Transfer)	xx	By Profit on Sale of Fixed assets	xxx
To Provision for Taxation	xx		
To Proposed Dividend	xx	By Profit on revaluation of fixed assets	xxx
To Loss on sale of fixed assets	xx	By Funds from operation (Balancing figure)	xxx
To Net Profit	xx		
(current year)	xx		
	xxxx		xxxx

Illustration 2

From the following Profit and Loss Account, calculate funds from operations under both the methods as stated above.

Profit and Loss Account

		Rs.			Rs.
To Opening Stock		1,28,000	By Sales	4,10,000	
To Purchases	1,60,000		Less:Returns	10,000	4,00,000
Less : Returns	32,000	1,28,000	By Closing Stock		3,20,000
To Wages paid	80,000				
Add : Outstanding	40,000	1,20,000			
To Gross Profit c/d		3,44,000			
		7,20,000			7,20,000
To Rent paid		40,000	By Gross Profit b/d		3,44,000
To Salary		1,00,000	By Interest on Investments		10,000
To Depreciation		12,000			
To Discount on issue of shares		50,000			
To Preliminary expenses (written off)		20,000			
To Goodwill (written off)		24,000			
To Net Profit c/d		1,08,000			
		3,54,000			3,54,000

Solution

Method I

Statement of Funds from Operations

		Rs.	Rs.
Net Profit as per Profit and Loss account			1,08,000
Add:	Depreciation	12,000	
	Discount on issue of shares	50,000	
	Preliminary expenses	20,000	
	Goodwill written off	24,000	1,06,000
			2,14,000
Less:	Interest on investments	10,000	10,000
	Funds from operations		2,04,000

Method II

Adjusted Profit and Loss Account

	Rs.		Rs.
To Depreciation	12,000	By Net Profit (Previous year)	—
To Discount on issue of shares	50,000	By Interest on investments	10,000
To Preliminary expenses	20,000	By Funds from operations (Balancing figure)	2,04,000
To Goodwill written off	24,000		
To Net Profit (Current year)	1,08,000		
	2,14,000		2,14,000

When all the information is available, it is relatively easy to calculate the amount of funds from operations. Some times, full information is not available and it becomes necessary to dig out the hidden information on the basis of clues available. Let us now study a few situations involving such items and learn how will these be ascertained and adjusted for determining the amount of funds from operations.

1) **Depreciation**

It is a practice in every business to write off dipreciation on fixed assets which is debited to Profit and loss account and a corresponding credit to Fixed asset account. Since, both profit and loss account and the Fixed asset account are non-current accounts, depreciation is a non-fund item. It is neither a source nor an application of funds. It is added back to operating profit to find out Funds from operations.

When the profit and loss account is given, whether in full or as a summary thereof, the amount charged as depreciation can be easily ascertaind. But when any details regarding the income statement are not given, the depreciation amount is to be ascertained from the data given in the balance sheet and from the other available information. If the figures given in two Balance Sheets show the opening and closing balances of the asset concerned at their depreciated value (cost less depreciation till date) and there is no mention of purchase and sale of the asset during that year, the difference between the opening and closing balance may be considered as the depreciation charged during the years. Sometime, the fixed assets are shown at cost on the assets side and the depreciation or, as a provision for depreciation or as accumulated depreciation, is either shown as a deduction from the fixed asset concerned or appears on the liabilities side. In such a situation, the increase in the amount of accumulated depreciation during the year (assuming that there were no purchases and sales of fixed assets) must be taken as the amount of depreciation charged during that year. Study Illustrations 3 given below and learn how will the amount of depreciation is to be ascertained.

Illustration 3

From the following, ascertain the amount of machinery for the year 2005:

Balance Sheet (asset-side only)

	As on 31.12.2004	**As on 31.12.2005**
Furniture at Cost - less depreciation	Rs. 80,000	Rs. 1,00,000

Other information : Depreciation Charged during the year on Machinery Rs. 8000

Solution

Machinery Account

	Rs.		**Rs.**
To Balance B/d	80,000	By Depreciation	8,000
To Bank (Purchases) (Balancing figure)	28,000	By Balanace c/d	1,00,000
	1,08,000		1,08,000

Though the difference between the figures of the asset on two balance sheet dates is Rs. 20,000, the value of machinery bought during the year is Rs. 28,000 and not Rs. 20,000. This has been worked out after taking into account the amount of Rs. 8000 as depreciation.

2) **Profit or Loss on Sale of Fixed Assets**

When a fixed asset is sold at a price which is higher than its book value, the profit on its sale is credited to profit and loss account. Hence, this amount will have to be deducted from the net profit in order to ascertain the amount of funds from operations. Similarly, when a fixed asset is sold at a loss (price is less than its book value), the loss is charged to profit and loss account and it becomes necessary to add back this amount to the net profit so as to show the correct amount of funds from operations. The purpose of adjusting the amounts of profit or loss on sale of fixed assets in the net profit is to avoid double counting of such profit or loss as the same is already included/excluded in the amounts from the sale of the fixed assets which would be shown separately as a source of fund. Thus, the actual sale of fixed assets are shown as a source of funds, and, if there is a profit on sale it must be subtracted from the net profit, and, if there is a loss the same must be added back to the net profit. This adjustment is necessary for ascertaining the correct amount of funds provided by operations.

If complete information is available with regard to purchase and sale of fixed assets it will not be a problem to ascertain the amount of depreciation, value of assets purchased, sale proceeds, gain/loss on such a sale and depreciation charged till the date of sale of the assets sold. When detailed information is not available, then you have to ascertain the hidden information. Look at the following illustration 4:

Illustration 4

Extracts of Balance Sheet

Liabilities	As on 31-12-04 Rs.	As on 31-12-05 Rs.	Assets	As on 31-12-04 Rs.	As on 31-12-05 Rs.
Accumulated Depreciation	50,000	75,000	Machinery	37,500	90,000

Net profit for the year was Rs.75,000. Machinery with an original cost of Rs. 12,500 was sold (accumulated depreciation on it being Rs. 5,000) for Rs.10,000. Ascertain the amounts of depreciation, funds from operations, and asset purchased.

Solution

Accumulated Depreciation Account

	Rs.		Rs.
To Depreciation on Machinery sold	5,000	By Balance b/d	50,000
To Balance c/d	75,000	By P& L A/c- Depreciation charged (Balancing figure)	30,000
	80,000		80,000

Machinery Account

	Rs.		Rs.
To Balance b/d	37500	By Accumulated Depreciation	5,000
To P & L A/c (gain on sale)	2,500	By Cash (sale)	10,000
To Cash — purchase (balancing figure)	65,000	By Balance c/d	90,000
	1,05,000		1,05,000

Gain on Machinery Sold

Book Value	12,500
Less: Depreciation	5,000
Depreciated value	7,500
Sale price	10,000
Gain on sale	2,500

Funds from Operations:

Net profit as reported	75,000
Add : Depreciation charged	30,000
	1,05,000
Less : Gain on Sale	2,500
Funds from Operations	1,02,500

Note : The total sale proceeds of Rs. 10,000 will be shown as a source of fund in the fund flow statement.

If we had merely compared the opening and closing balances of the accumulated depreciation account, we would have wrongly concluded that depreciation charged during the year was only Rs. 25,000. The sale of an old asset required that the accumulated depreciation in respect there of should be transferred from accumulated depreciation account to the concerned asset account, and it is only after incorporating this entry that the actual depreciation charged during the year can be correctly ascertained Thus, the depreciation charged during the year works out to Rs. 30,000 and not Rs. 25,000. This amount of depreciation charged during the year has been added back to the net profit, in order to ascertain funds from operations as the same must have been debited to profit and loss account earlier.

3) **Profit or Loss on sale of Long term Investments**

If a company made long term investment in other company, such investment must be considered as non-current item like a fixed asset. If there is any profit or loss on their sale, it would be dealt in the same manner as the profit or loss on the sale of fixed assets. On the other hand, if the investments made are only for a short period, in such a case the investments must be treated as an item of current asset. Any changes in short term investments will appear in the schedule of changes in working capital, otherwise it would appear directly in funds flow statement.

4) **Amortisation of Expenses and Writing Off of Intangible Assets**

Sometimes, a firm decides to write off a portion of its intangible assets like goodwill, patents, copy rights, etc., by charging it to the profit and loss account. Similarly, it may decide to write off deferred revenue expenses, like preliminary expenses, discount on issue of shares, etc., by charging some amount to the profit and loss account. These write off amounts, like depreciation, are non-cash costs and reduce the amount of profit. But they do not affect flow of funds. For this reason, such amounts must be added back to the net profit to determine the amount of funds provided by operations.

5) **Provision for Taxation**

Provision for taxation represents the amount likely to be paid as tax after the assessment is complete during the next accounting period. Thus, provision for taxes is shown as a current liability in the balance sheet, and if for purposes of preparing fund flow statement it is treated as such, this would appear in the schedule of changes in working capital, and the amount of tax paid during the year will not be shown as an application in the fund flow statement. However, as per practice, tax on profits is normally treated as a non-current item for preparing the fund flow statement. Hence, this will not be taken to the statement of changes in working capital. In fact, the provision made during the current year will have to be added back to net profit to find out the amount of funds from operations, as the same must have been debited to profit and loss account earlier. As for the amount of tax paid, it must be shown as an application of fund in the fund flow statement. It may be noted that if no additional information is available, the provision for tax shown in the previous year's balance sheet shall be taken as the tax paid during the year, and the provision for tax shown in current years' balance sheet be treated as the amount of tax provided during the current by debiting it to the current year's profit and loss account. Of course, this amount will have to be added back to net profit for ascertaining funds from operations. This treatment of taxation is in strict conformity with the requirements of the Accounting Standard on State of Changes in Position of Funds (AS-3).

6) **Proposed Dividends**

Proposed dividend, as in the case of provision of taxation, can be treated either a current liability or as a non-current liability and its treatment will differ accordingly. In case it is treated as a current liability, it will appear as one of the items in the schedule of changes in working capital and the amount of dividend paid will not be shown as an application of funds in fund flow statement. But, as per the requirement of AS-3, the proposed dividends are also to be treated as a non-current item for purposes of fund flow statement. As such proposed dividends will not find a place in the schedule of changes in working capital. The amount of proposed dividends relating to current year if already deducted from profits, shall be added back for ascertaining the amount of funds from operations, and the dividends actually paid during the year will be shown as an application of funds. It may be noted that, just like provision for tax, if no details are available, the proposed dividends shown in the previous year's balance sheet shall be taken as dividends paid during the year and the proposed dividends shown in current year's balance sheet shall be treated as the amount of dividends provided during the current year by debiting it to the current year's profit and loss appropriation account.

7) **Provision for Doubtful Debts**

Provision for doubtful debts is treated as a current item as it relates to an item of current asset (debtors) and therefore it should appear in the schedule of changes in working capital.

6.9.3 Preparation of Funds Flow Statement (on working capital basis)

Funds flow statement is a statement which explains about the movement of funds where from working capital originates and where into the same goes during the accounting period. While preparing funds flow statement, current assets and current liabilities are to be ignored and only changes in non-current assets and non-current liabilities are taken into account. In otherwords, funds flow statement is prepared on the basis of the changes in fixed assets, long term liabilities and share capital shown in the Balance Sheet after taking into account the additional information given, if any. This statement has two parts, Sources of funds and Application of funds. The difference between sources and application of funds shows the net changes in the working capital during a specified period. The transactions which increase working capital are sources of funds and the transactions which decrease working capital are application of funds. Therefore, funds flow statement is also called as a Statement of Sources and Application of Funds, Inflow-outflow of Funds Statement etc.

This can be prepared either in a (1) Statement Form, or (2) Account Format as given below:

1) **Statement Form :**

Proforma of Fund Flow Statement

Fund Flow Statement for the year ending ....

		Rs.	Rs.
A)	**Sources of Funds :**		
	1) Funds from operations	---------------	
	2) Issue of share capital	---------------	
	3) Issue of debentures	---------------	
	4) Long-term loans raised	---------------	
	5) Sale of fixed assets	---------------	
		---------------	xxxx
B)	**Uses of funds**		
	1) Operating loss, if any	---------------	
	2) Redemption of preference share capital	---------------	
	3) Redemption of debentures	---------------	
	4) Repayment of long- term liabilities	---------------	
	5) Purchase of fixed assets	---------------	
	6) Payment of dividends (final and interim)	---------------	
	7) Payment of taxes	---------------	
		---------------	xxxx
	Increase/Decrease in Working Capital (A-B)		xxxx

2) **Account Format**

Proforma of Fund Flow Statement
Fund Flow Statement for the year ending.............

Sources	**Rs.**	**Uses**	**Rs.**
Funds from operations	....	Operating loss, if any	....
Issue of Share capital	....	Redemption of preference share capital	....
Issue of debentures	....	Redemption of debentures	....
Long term loans raised	....	Repayment of long term loans	....
Sale of fixed assets	....	Purchases of fixed assets	....
Decrease of Net Working Capital	....	Payment of dividends (final and interim) Payment of tax	....
(Balanicing figure)	....	Increase of Net Working Capital (Balanicing figure)	....
Total		**Total**	

6.9.4 Steps in Preparation of Funds Flow Statement

To prepare funds flow statement, sources and application of funds have to be ascertained. The usual sources of funds and uses of funds are as follows:

1) Funds From Operation: Identify profit after tax but before any appropriation. With that value, add the following values:
   - Depreciation on fixed assets
   - Any expenses written off during the year
   - Loss on sale of fixed assets and investments

   Deduct the following:
   - Profit on sale of fixed assets and investments
   - Profit on revaluation of fixed assets
   - Non-operating incomes
2) Fresh issue of Equity shares, issue of debentures, fresh loan from financial institutions, etc. are next major sources of funds.
3) Sale proceeds of fixed assets and investments are next source of funds.
4) Non-operating income, which was deducted earlier to compute funds from operation has to be added at this stage since it is also source of funds.
5) The above four sources of funds give your gross value of funds generated during the year. From this value deduct the following uses of funds of long-term nature.
6) Purchase of fixed assets and investments has to be deducted.
7) Repayment of loan, debentures, share repurchase are to be deducted.
8) Payment of dividend, income-tax, etc., are to be reduced.
9) The difference between the sources and uses of funds calculated above is sources of funds from long-term operations.
10) Find out changes in current assets and current liabilities values of two periods and compute how much net change on working capital. The net changes in working capital will be equal to net changes in long-term sources and uses.

6.10 FUNDS FLOW VS. OTHER FINANCIAL STATEMENTS

Funds flow statement is unique compared to other statement since it converts a stock statement (balance sheet) into a flow statement. As such, there is not much of comparison or relationship between funds flow and other financial statements. When compared to cash flow statements, which will be discussed in the next section, funds flow gives a broader view of financial flow. While cash flow shows how cash balance changed from one period to another period, funds flow statement typically shows the changes in the balances of working capital, which includes cash balance. Normally, funds flow statement is used to understand long-term stability of business whereas cash flow statement is used to find out short-term stability. Cash flow statement can be used to assess the quality of reported profit, whereas it would be difficult to do such exercise with funds flow statement.

There are significant differences between funds flow statement and profit and loss account. Though both of them are flow or period statement, profit and loss account excludes all capital-related transactions like capital expenditure or capital receipts.

Funds flow statement considers both revenue and capital items. The only relationship between the two statements is both are concerned with funds raised through operating activities. To get funds from operating activities, we use profit and loss statement and perform some adjustments.

As discussed earlier, funds flow statement is a kind of extension of Balance Sheet. There are number of similarities between the two statements. Many accounting heads of both statements are common and the only difference is the valuation. While Balance Sheet shows the figure as on a particular date, Funds Flow Statement shows the period value. While Balance Sheets values are normally positive, funds flow statement may show negative values on some of the items. For instance, consider secured loan item of Balance Sheet. It might show a value of Rs. 200 lakhs last year and Rs. 150 lakhs at the end of current year. Both are positive values. In Funds Flow Statement, the secured loan account will have negative value of Rs. 20 lakhs, since this much of amount is repaid and hence it is application of funds. While Balance Sheet is a single statement, funds flow is normally prepared in two stages and includes working capital statement.

Activity 3

1) Visit some of the web sites of large Indian companies, which have also issued American Depository Receipts (ADR). From the web sites, download the P&L account as per Indian Accounting Standards and also P&L account drawn under US accounting standards (called US GAAP). Compare the two statements and then briefly write your overall observations.

   ....

   ....

   ....

2) Why do feel that the two figures are different? List down some of the dominant reasons.

   ....

   ....

   ....

3) Now, you check the cash flow statement reported under two systems and list down your observations.

   ....

   ....

   ....

6.11 IMPORTANCE OF FUNDS FLOW STATEMENT

An important contribution of funds flow statement is to know how funds have moved between long-term and short-term needs of the organisation. It is generally believed that organisation needs to match assets and liabilities on time scale though assets are always equal to liabilities. For instance, if a firm raises funds through 364 days commercial paper and uses the money to buy a plant. There is a asset-liability mismatch between the sources and uses of funds. Suppose, the interest rate is 10% and expected return from the project is 12%. Today, the project looks profitable. But what will happen when the interest rate increases to 13% from 10% at the end one year. If the commercial paper is renewed or new commercial paper is substituted for the same, the project profitability turns negative. Further, what is the assurance that the company would be in a position to roll-over the commercial paper or substitute a new paper. If there is delay or difficulty in doing it, it will put lot of pressure on the part of organisation. Thus, prudential norms require use of long-term funds for long-term purpose and short-term funds for short-term needs, which is mainly working capital. Since it is difficult to exactly match this way, normally, if the flow is from long-term sources to short-term uses, then it is considered to be a good funds management. Here again, too much of excessive use of long-term funds for short-terms is not good. Funds flow statement shows how efficient the firm is in managing two sources of funds.

Funds flow statement is also useful to ascertain whether the firm is liquid or not and whether the firm is in a position to raise funds from operation to sustain its activities. If the firm has set some budgets, which show the funding pattern of future expansion, funds flow statement will be useful to compare whether we are able to achieve the budget terms. If the funds flow statement is prepared for the future years, then it is possible for the management to plan in advance how to manage the funds and what steps need to be taken today to raise different sources of funds.

An analysis of working capital statements will be useful to know where the need for working capital arises. Other things being equal, it is desirable to reduce the working capital since investments in working capital yield very low return or zero return. It is also possible to compare this statement with budgets to control the growth of working capital. Let us consider the Funds Flow Statement of BHEL to understand this point.

Bharat Heavy Electricals Ltd.
Funds Flow Statement

					(Rs. in Crores)
Year	2001-02	2000-01	1999-2000	1998-99	1997-98
Sources of Funds					
Funds From Operation	881.15	443.53	715.52	667.64	827.08
Funds from Fresh Loans	0.00	784.90	70.58	0.00	0.00
Sale of Investments	0.00	0.00	4.76	9.00	110.96
Miscellaneous Sources	0.00	12.35	0.00	10.73	17.96
Total	**881.15**	**1240.78**	**790.86**	**687.37**	**956.00**
Application of funds					
Decrease in Loan funds	381.10	0.00	0.00	219.43	508.48
Investments in Fixed Assets	173.44	181.98	152.60	243.53	315.64
Dividend	97.91	73.43	73.42	61.19	61.19
Miscellaneous Uses	20.69	0.00	238.63	0.00	0.00
Total	**673.14**	**255.41**	**464.65**	**524.15**	**885.31**
Net Funds from long-term sources	208.01	985.37	326.21	163.22	70.69
Increase in Working Capital	208.01	985.37	326.21	163.22	70.69

BHEL working capital is showing steady increase over the years. However, in all the five years, BHEL was able to generate adequate long-term funds to meet the increasing short-term needs.

Let us consider one more large Indian company to understand the issue. Sterlite Industries funds flow statement given below shows wide variation in the flow of funds. Of the five years, funds from long-term sources turned negative and it means, short-term sources are used to fund the long-term needs. As we know, Sterlite made a number of acquisition and in that process, there are some deviations in resources planning. As you see, the company is setting right the situation in 2001. by bringing down the gap and hopefully, it will come to normal in year 2002.

Sterlite Industries (India) Ltd.
Funds Flow Statement

					(Rs. in Crores)
Year	2001-02	2000-01	1999-2000	1998-99	1997-98
Sources of Funds					
Funds From Operation	–166.03	130.48	512.77	235.78	191.02
Funds from Fresh Loans	11.34	0.00	110.27	0.00	188.17
Sale of Investments	2.34	0.00	4.86	0.00	0.00
Miscellaneous Sources	2.53	1.20	35.85	10.88	0.52
Total	**–149.82**	**131.68**	**663.75**	**246.66**	**379.71**
Application of funds					
Decrease in Loan funds	0	169.08	0	73.14	0
Investments in Fixed Assets	44.57	4.75	85.14	93.05	419.97
Purchase of Investments	0	737.52	0	2.25	10.35
Dividend	1.81	33.64	57.51	45.32	38.53
Miscellaneous Uses	5	20	0	0	0
Total	**51.38**	**964.99**	**142.65**	**213.76**	**468.85**
Net Funds from long-term sources	–201.20	–833.31	521.10	32.90	–89.14
Increase in Working Capital	–201.20	–833.31	521.10	32.90	–89.14

6.12 LET US SUM UP

The statement of changes of financial position explains the differences in various assets and liabilities items of balance sheet between the beginning of the year and end of the year. It converts balance sheet into a flow statement. An increase in liability side means the organisation has generated funds during the period. There are broadly three sources of funds - funds from operation, funds from other long-term sources like equity, loan, etc. and funds generated from working capital (e.g. increase in payables). There are broadly two uses of funds namely, funds required to buy assets and other long-term need and funds required for current assets (purchase of inventory, funding receivables, etc.). Funds flow statement can be prepared on cash basis or working capital basis. Funds flow on cash basis is similar to cash flow statement and hence there is limited use since all companies are asked to give cash flow statement under AS-3. Funds flow statement on working capital basis throws some insight further on the flow of funds between long-term and short-term needs of organisation.

Funds flow statement is not required under the current Accounting Standards and hence very few companies provide such statement. Further, funds flow statement is not free from window dressing since uses only the two principal financial statements. Many organisations prepare funds flow statement for internal purpose and normally it is compared with budgets to set right deviation from budgets.

6.13 KEY WORDS

Funds: Cash or net working capital.

Flow of funds: Movement or change in the net working capital.

Current Assets : Cash and other assets that are converted into cash or consumed in the production of goods in the normal course of business.

Fund Flow Statement: Statement which shows the sources (inflows) and uses (outflows) of funds between two balance sheet dates.

Funds from Operations: The amount of net profit that acts as a source of fund i.e., profit before charging certain non-cash costs and before crediting items like profit on sale of fixed assets.

Current - liabilities : Liabilities payable within one year.

Gross Working Capital : Total of current assets.

Net Working Capital: Excess of current assets over current liabilities.

Non-Current Items: Long term asset and long-term liabilities.

Schedule of Changes in Working Capital: Statement which reveals the effect of item wise change in current asset and current liabilities on the net working capital between two balance sheet dates.

Working Capital: That part of the capital which is required for recoming operations of a business as distinguished from capital invested in fixed assets.

6.14 TERMINAL QUESTIONS

1) Compared to two principal financial statements namely, Profit and Loss Account and Balance Sheet, what is additional insight you get from funds flow statement?

2) "Funds flow statement is only supplementary to P&L Account and Balance Sheet; it can't be substitute to P&L Account and Balance Sheet" - Do you agree to this statement? Explain your views.

3) Discuss a few basic differences between "cash" concept of funds flow statement and "working capital" concept of funds flow statement.

4) A firm is found to have negative changes in working capital. What does it mean? Is it good for the firm in the long-run if the negative change in working capital continues for a long period?

5) "Funds Flow Statement also suffers from window dressing of accounts and hence fails to give true view of funds movement; for instance, funds from operation can be increased by recording a few dummy sales" - Do you agree to this criticism? Give your views.

6) From the following figures, prepare Funds Flow Statement under both methods and then give your comments and observations.

	Year 1	Year 2
Assets		
Fixed Assets (Net Block)	510000	620000
Investments	30000	80000
Current Assets	240000	375000
Discount on Issue of Debentures	10000	5000
Total	**790000**	**1080000**
Liabilities		
Equity Share Capital	300000	350000
14% Preference Share Capital	200000	100000
14% Debentures	100000	200000
Reserves	110000	270000
Provision for Doubtful Debts	10000	15000
Current Liabilities	70000	145000
Total	**790000**	**1080000**

Additional Details

a) Provision for Depreciation stood at 150000 at the end of Year 1 and Rs. 190000 at the end of Year 2.

b) During the year, a machine costing Rs. 70000 (book value Rs. 40000) was disposed of for Rs. 25000.

c) Preference shares redemption was carried out at a premium of 5%.

d) Dividend @ 15% was paid on equity shares for the year 1 during the year 2.

7) Following is the summarised Balance Sheet of Bombay Industries Ltd. as on December 31, 2004 and 2005 :

Balance Sheet

Liabilities	**2004 Rs.**	**2005 Rs.**	**Assets**	**2004 Rs.**	**2005 Rs.**
Sundry Creditors	40,400	43,200	Cash and Bank	44,600	47,800
Bills Payable	10,800	12,200	Debtors	10,800	17,000
Outstanding Rent	2,600	1,000	Stock-in-trade	44,000	67,200
Mortgage Loan	22,000	21,000	Temporary Investments	30,200	8,000
Share Capital	2,80,000	3,20,000	Plant & Machinery	2,54,600	3,35,800
Reserves	1,12,600	1,31,600	Land	50,000	50,000
Proposed Dividend	28,000	32,000	Long-term investment	62,200	35,200
	4,96,400	5,61,000		4,96,400	5,61,000

You are required to prepare schedule of changes in working capital.

8) Funds Flow Statements of two large Indian textile companies are given below. Analyse and give your views on the performance of the companies.

Bombay Dyeing & Manufacturing Company Ltd
Funds Flow Statement (Rs in Cr.)

Year	2002-03	2001-02	2000-01	1999-2000	1998-99
Sources of Funds					
Funds From Operation	68.18	-286.50	38.16	79.74	1122.22
Funds from Fresh Loans	88.45	-	-	-	667.58
Sale of Investments	-	193.33	115.38	-	-
Miscellaneous Sources	-	46.09	-	-	-
Total	**156.63**	**–47.09**	**153.54**	**79.74**	**1789.8**
Application of funds					
Decrease in Loan funds	0.00	305.42	4.48	65.23	0.00
Investments in Fixed Assets	-5.49	-21.08	31.76	17.49	847.61
Purchase of Investments	156.94	0.00	0.00	16.35	421.94
Dividend	11.54	7.83	8.20	12.30	12.30
Miscellaneous Uses	0.00	0.00	9.30	7.01	29.78
Total	**162.99**	**292.17**	**53.74**	**118.38**	**1311.63**
Net Funds from long-term sources	**–6.36**	**–339.3**	**99.8**	**–38.64**	**478.17**
Increase in Working Capital	**–6.36**	**–339.3**	**99.8**	**–38.64**	**478.17**

Raymond Ltd.
Funds Flow Statement (Rs. in Crore)

Year	2002-03	2001-02	2000-01	1999-2000	1998-99
Sources of Funds					
Funds From Operation	130.40	98.52	165.53	129.21	165.74
Funds from Fresh Loans	0	4.36	0	0	0
Sale of Investments	0	19.78	0	0	15.92
Miscellaneous Sources	1.10	0.90	0	3.09	0
Total	**131.50**	**123.56**	**165.53**	**132.30**	**181.66**
Application of funds					
Decrease in Loan funds	49.69	0	237.51	140.79	71.51
Investments in Fixed Assets	75.41	53.05	–401.60	17.43	86.85
Purchase of Investments	24.66	0	421.61	89	0
Dividend	27.62	27.62	18.41	11.26	15.02
Miscellaneous Uses	0	0	0.21	0	2.75
Total	**177.38**	**80.67**	**276.18**	**258.48**	**176.13**
Net Funds from long-term sources	–45.88	42.89	–110.70	–126.20	5.53
Increase in Working Capital	**– 45.88**	**42.89**	**–110.70**	**–126.20**	**5.53**

9) Calculate the Funds from Operations from the following Profit and Loss Appropriation Account.

	Rs.		Rs.
Salaries	25,000	Gross profit	1,50,000
Rent	9,000	Profit on sale of buildings:	
Depreciation on plant	15,000	Book value Rs. 45,000	
Preliminary expenses Written off	6,000	Sold for Rs. 30,000	
Printing and stationery	9,000		15,000
Goodwill written off	9,000		
Provision for tax	12,000		
Proposed dividends	8,000		
Net Profit	72,000		
	1,65,000		1,65,000

(Answer: Rs. 1,07,000)

Note: Provision for tax is treated as a non-current item.

10) Calculate fund/loss from operations from the fol1owing data:

	Rs.
P & L Alc (credit balance) as on April 01, 2004	70,600
P & L Ale (credit balance) as on March 31, 2005	30,000
Loss on issue of debentures	12,000
Operating expenses	28,000
Premium of expenses written Off	13,000
Transfer to general reserve	15,000

(**Answer:** Operating Loss: Rs.600 No adjustment is needed for operating expenses.)

11) From the following Balance Sheets, prepare Statement of Changes in Working Capital and Adjusted Profit and Loss A/c for ascertaining Funds from Operations.

Liabilities	31.3.2004 Rs.	31.3.2005 Rs.	Assets	31.3.2004 Rs.	31.3.2005 Rs.
Share Capital	1,50,000	2,00,000	Goodwill	57,500	45,000
8% Redeemable			Buildings	1,00,000	85,000
Preference Share			Plant	40,000	1,00,000
Capital	75,000	50,000	Debtors	80,000	1,00,000
General Reserve	20,000	35,000	Stock	38,500	54,500
Profit & Loss A/c	15,000	24.000	Bills Receivable	10,000	15,000
Proposed Dividend	21,000	25,000	Cash	7,500	5,000
Creditors	27,500	41,500	Bank	5,000	4,000
Bills Payable	10,000	8,000			
Provision for Tax	20,000	25,000			
	3,38,500	4,08,500		3,38,500	4,08,500

Additional Information

a) Depreciation of Rs. 10,000 and Rs. 15,000 has been charged on Plant and Buildings respectively.

b) lncome tax of Rs. 17,500 has been paid during the year.

(**Answer :** Increase in Working Capital : Rs. 25,500; Funds from Operation Rs. 1,09,000)

12) Prepare a statement of funds from operations and the schedule for changes in working capital

Liabilities	31.3.2004 Rs.	31.3.2005 Rs.	Assets	31.3.2004 Rs.	31.3.2005 Rs.
Share Capital	25,00,000	20,00,000	Fixed Assets	15,50,000	15,00,000
Surplus	7,50,000	2,50,000	Investments	75,000	—
Proposed Dividend	5,00,000	6,00,000	Stock	37,50,000	39,37,500
			Debtors	20,00,000	17,50,000
Secured loans	12,50,000	14,00,000	Cash & bank	1,25,000	62,500
Current liabilities	25,00,000	30,00,000			
	75,00,000	72,50,000		75,00,000	72,50,000

Additional Information

a) Dividend paid during 2004-05 Rs. 2,50,000.

b) Depreciation on fixed assets for the year Rs. 1.5 lakh.

(**Answer :** Decrease in Working Capital: Rs. 6,25,000; Funds from operations Rs. 8,00,000).

13) From the following Balance Sheets of ABC company Ltd., prepare:

i) Statement of Changes in Working Capital.

ii) Funds Flow Statement.

Liabilities	31.3.2004 Rs.	31.3.2005 Rs.	Assets	31.3.2004 Rs.	31.3.2005 Rs.
Creditors	45,000	20,000	Goodwill	5,000	12,000
Bills Payable	35,000	23,000	Cash	70,000	25,000
12% Debentures	80,000	—	Debtors	90,000	98.000
Share Capital	1,25,000	1,50,000	Stock	1,20,000	87,000
Profit & Loss a/c	42,000	62,000	Investments	10,000	15,000
			Land (Cost)	27,000	15,000
			Preliminary Expenses	5,000	3,000
	3,27,000	2,55,000		3,27,000	2,55,000

Additional lnformation

i) Land sold for Rs. 24,000

ii) Dividend paid Rs. 30,000

iii) Debentures redeemed at a premium of 10%.

(Ans : Net decrease in working capital Rs. 33,000 Funds operations : Rs. 41,000)

14) From the following Balance sheets of a Company as on 31st March, 2004 and 31st March 2005 you are required to prepare Schedule of Changes in the Working Capital and a Funds Flow Statement

Liabilities	31.3.2004 Rs.	31.3.05 Rs.	Assets	31.3.2004 Rs.	31.3.05 Rs.
Share Capital	1,00,000	1,50,000	Non-current Assets	1,00,000	2,00,000
Profit & Loss Account	40,000	60,000	Current Assets	1,30,000	1,40,000
Provision for Taxes	20,000	30,000	Discount on Issue		
Proposed Dividend	10,000	15,000	of Shares	–	5,000
Creditors	25,000	37,000			
Bills Payable	15,000	22,500			
Outstanding Expenses	20,000	30,500			
	2,30,000	3,45,000		2,30,000	3,45,000

Additional Information is given below:

(i) Tax paid during 2004-05 Rs. 25,000; (ii) Dividend paid during 2004-05 Rs. 10,000.

(**Answer :** Net decrease in working capital : Rs. 20,000, Funds From operations : Rs. 70,000)

Note : These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

6.15 FURTHER READINGS

Robert N Anthony and James S Reece, *Management Accounting: Text and Cases*, Richard D. Irwins Inc, Homewood, Illinois.

M C Shukla, T S Grewal and S C Gupta, *Advanced Accounts (Volume II)*, S.Chand & Company Ltd. New Delhi.