UNIT 7 CASH AND FUNDS FLOW STATEMENTS
MODULE - 2

UNIT 7 CASH AND FUNDS FLOW STATEMENTS

NOTES

Structure

7.0 INTRODUCTION

Information about the cash flow of an enterprise is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilize those cash flows. The economic decisions that are taken by the users require an evaluation of the ability of an enterprise to generate cash and cash equivalents and the timing and uncertainty of their generation. In view of the importance of cash flows in decision making, an enterprise should prepare a cash flow statement giving both inflows and outflows of cash during a particular period. A cash flow statement, when used in conjunction with other financial statements, provides information that enables its users to evaluate the changes in net assets of an enterprise, its financial structure and its ability to affect the amount and timings of the cash flows in order to adapt to changing circumstances. The present unit deals with all these aspects in detail.

NOTES

The Funds Flow Statement[1] is widely used by financial analysts, credit granting institutions and financial managers in performance of their jobs. It has become a useful tool in their analytical kit. This is because the financial statements, i.e., 'Income Statement' and the 'Balance Sheet' have a limited role to perform. Income Statement measures flow restricted to transactions that pertain to rendering of goods or services to customers. The balance sheet is merely a static statement. It is a statement of assets and liabilities as on a particular date. It does not sharp by focus those major financial transactions which have been behind the balance sheet changes. One has to draw inferences from the Balance Sheet about major financial transactions only after comparing the Balance Sheets of two periods. For example, if the fixed assets worth Rs 2,00,000 are purchased during the current year by raising share capital of Rs 2,00,000, the Balance Sheet will simply show a higher capital figure and higher fixed assets figure. In case, one compares the current year's Balance Sheet with the previous year's Balance Sheet, then only one can draw an inference that fixed assets were acquired by raising share capital of Rs 2,00,000. Similarly, certain important transactions which might occur during the course of the accounting year might not find any place in the Balance Sheet. For example, if a loan of Rs 2,00,000 was raised and paid in the accounting year, the Balance Sheet will not depict this transaction. However, a financial analyst must know the purpose for which the loan was utilised and the source from which it was raised. This will help him in making a better estimate about the company's financial position and policies. In the following pages, we are explaining the meaning and utility of this type of statement and the technique of preparing it.

7.1 UNIT OBJECTIVES

After going through this unit, you will be able to:

- Explain the meaning of cash flow statement
- Understand the concept of funds in cash flow analysis
- Identify the sources and applications of cash
- Differentiate between cash flow analysis and funds flow analysis
- Explain the utility and limitations of cash flow analysis
- Prepare cash flow statement
- Understand the meaning of 'funds flow statement';
- Identify transactions which involve changes in funds;
- Explain the purpose and utility of funds flow statement;
- Differentiate the funds flow statement from income statement and balance sheet;
- Prepare funds flow statement;
- Explain the meaning of certain key terms

7.2 MEANING OF CASH FLOW STATEMENT

A Cash Flow Statement is a statement depicting change in cash position from one period to another. For example, if the cash balance of a business is shown by its Balance Sheet on 31 December, 1997 at Rs 20,000 while the cash balance as per its Balance Sheet on 31 December, 1998 is 30,000, there has been an inflow of cash of Rs 10,000 in the year 1998 as compared to the year 1997. The cash flow statement explains the reasons for such inflows or outflows of cash, as the

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[1] It is also termed as 'Statement of Changes in Financial Position (Working Capital basis)'.

case may be. It also helps management in making plans for the immediate future. A Projected Cash Flow Statement or a Cash Budget will help the management in ascertaining how much cash will be available to meet obligations to trade creditors, to pay bank loans and to pay dividend to the shareholders. A proper planning of the cash resources will enable the management to have cash available whenever needed and put it to some profitable or productive use in case there is surplus cash available.

The term 'Cash' here stands for cash and bank balances. It has already been explained in the previous unit that the term 'Funds', in a narrower sense, is also used to denote cash. In such a case, the term 'Funds' will exclude from its purview all other current assets and currents liabilities and the term 'Funds Flow Statement' and 'Cash Flow Statement' will have synonymous meanings. However, for the purpose of this study, we are calling this part of study Cash Flow Analysis and not Funds Flow Analysis.

7.3 PREPARATION OF CASH FLOW STATEMENT

The Cash Flow Statement can be prepared on the same pattern on which a Funds Flow Statement is prepared. The change in the cash position from one period to another is computed by taking in account 'Sources' and 'Applications' of cash.

BALANCE SHEET AS AT 31.12.1996

(*Rs.* '000)

Assets		*1996*		*1995*
Cash on hand and balances with banks		200		25
Short-term investments		670		135
Sundry debtors		1,700		1,200
Interest receivable		100		–
Inventories		900		1,950
Long-term investments		2,500		2,500
Fixed assets at cost	2,180		1,910	
Accumulated depreciation	(1,450)		(1,060)	
Fixed assets (net)		730		850
Total assets		6,800		6,660
Liabilities				
Sundry creditors		150		1,890
Interest payable		230		100
Income taxes payable		400		1,000
Long-term debt		1,110		1,040
Total liabilities		1,890		4,030
Shareholders' Funds				
Share capital		1,500		1,250
Reserves		3,410		1,380
Total shareholders' funds		4,910		2,630
Total liabilities and shareholders' funds		6,800		6,660

Statement of Profit and Loss for the period ended 31.12.1996

(*Rs.* '000)

Sales	30,650
Cost of sales	(26,000)
Gross profit	4,650
Depreciation	(450)
Administrative and selling expenses	(910)

Contd...

NOTES

Interest expense	(400)
Interest income	300
Dividend income	200
Foreign exchange loss	(40)
Net profit before taxation and extraordinary item	3,350
Extraordinary item - Insurance proceeds from earthquake disaster settlement	180
Net profit after extraordinary item	3,530
Income-tax	(300)
Net profit	3,230

Direct Method Cash Flow Statement [Paragraph 18(a)]

(Rs. '000)

		1996
Cash flows from operating activities		
Cash receipts from customers	30,150	
Cash paid to suppliers and employees	(27,600)	
Cash generated from operations	2,550	
Income taxes paid	(860)	
Cash flow before extraordinary item	1,690	
Proceeds from earthquake disaster settlement	180	
Net cash from operating activities		1,870
Cash flows from investing activities		
Purchase of fixed assets	(350)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividends received	160	
Net cash from investing activities		30
Cash flows from financing activities		
Proceeds from issuance of share capital	250	
Proceeds from long-term borrowings	250	
Repayment of long-term borrowings	(180)	
Interest paid	(270)	
Dividends paid	(1,200)	
Net cash used in financing activities		(1,150)
Net increase in cash and cash equivalents		750
Cash and cash equivalents at beginning of period (see Note 1)		160
Cash and cash equivalents at end of period (see Note 1)		910

Indirect Method Cash Flow Statement [Paragraph 18(b)]

(Rs. '000)

		1996
Cash flows from operating activities		
Net profit before taxation, and extraordinary item	3,350	
Adjustments for :		
Depreciation	450	
Foreign exchange loss	40	
Interest income	(300)	
Dividend income	(200)	
Interest expense	400	
Operating profit before working capital changes	3,740	
Increase in sundry debtors	(500)	
Decrease in inventories	1,050	
Decrease in sundry creditors	(1,740)	

Contd...

Cash generated from operations	2,550	
Income taxes paid	(860)	
Cash flow before extraordinary item	1,690	
Proceeds from earthquake disaster settlement	180	
Net cash from operating activities		1,870
Cash Flow Statements	35	
Cash flows from investing activities		
Purchase of fixed assets	(350)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividends received	160	
Net cash from investing activities		30
Cash flows from financing activities		
Proceeds from issuance of share capital	250	
Proceeds from long-term borrowings	250	
Repayment of long-term borrowings	(180)	
Interest paid	(270)	
Dividends paid	(1,200)	
Net cash used in financing activities		(1,150)
Net increase in cash and cash equivalents		750
Cash and cash equivalents at beginning of period (see Note 1)		160
Cash and cash equivalents at end of period (see Note 1)		910

NOTES

Notes to the cash flow statement

(direct method and indirect method)

1. **Cash and Cash Equivalents**

Cash and cash equivalents consist of cash on hand and balances with banks, and investments in money-market instruments. Cash and cash equivalents included in the cash flow statement comprise the following balance sheet amounts.

	1996	*1995*
Cash on hand and balances with banks	200	25
Short-term investments	670	135
Cash and cash equivalents	870	160
Effect of exchange rate changes	40	–
Cash and cash equivalents as restated	910	160

Cash and cash equivalents at the end of the period include deposits with banks of 100 held by a branch which are not freely remissible to the company because of currency exchange restrictions.

The company has undrawn borrowing facilities of 2,000 of which 700 may be used only for future expansion.

2. Total tax paid during the year (including tax deducted at source on dividends received) amounted to 900.

Alternative Presentation (indirect method)

As an alternative, in an indirect method cash flow statement, operating profit before working capital changes is sometimes presented as follows:

Revenues excluding investment income	30,650	
Operating expense excluding depreciation	(26,910)	
Operating profit before working capital changes		3,740

Working Notes

The working notes given below do not form part of the cash flow statement and, accordingly, need not be published. The purpose of these working notes is merely to assist in understanding the manner in which various figures in the cash flow statement have been derived. (Figures are in Rs. '000.)

NOTES

1. **Cash receipts from customers**

Sales		30,650
Add: Sundry debtors at the beginning of the year		1,200
		31,850
Less: Sundry debtors at the end of the year		1,700
		30,150

2. **Cash paid to suppliers and employees**

Cost of sales		26,000
Administrative and selling expenses		910
		26,910
Add: Sundry creditors at the beginning of the year	1,890	
Inventories at the end of the year	900	2,790
		29,700
Less: Sundry creditors at the end of the year	150	
Inventories at the beginning of the year	1,950	2,100
		27,600

3. **Income taxes paid (including tax deducted at source from dividends received)**

Income tax expense for the year (including tax deducted at source from dividends received)	300
Add: Income tax liability at the beginning of the year	1,000
	1,300
Less: Income tax liability at the end of the year	400
	900

Out of 900, tax deducted at source on dividends received (amounting to 40) is included in cash flows from investing activities and the balance of 860 is included in cash flows from operating activities (see paragraph 34).

4. **Repayment of long-term borrowings**

Long-term debt at the beginning of the year	1,040
Add: Long-term borrowings made during the year	250
	1,290
Less: Long-term borrowings at the end of the year	1,110
	180

5. **Interest paid**

Interest expense for the year	400
Add: Interest payable at the beginning of the year	100
	500
Less: Interest payable at the end of the year	230
	270

Cash Flow Statement for a Financial Enterprise

This illustration does not form part of the accounting standard. Its purpose is to illustrate the application of the accounting standard.

1. The illustration shows only current period amounts.
2. The illustration is presented using the direct method.

Cash flows from operating activities

(Rs. '000)

	1996
Interest and commission receipts	28,447
Interest payments	(23,463)
Recoveries on loans previously written off	237
Cash payments to employees and suppliers	(997)
Operating profit before changes in operating assets	4,224
(Increase) decrease in operating assets:	
Short-term funds	(650)

Contd...

Deposits held for regulatory or monetary control purposes	234
Funds advanced to customers	(288)
Net increase in credit card receivables	(360)
Other short-term securities	(120)
Increase (decrease) in operating liabilities:	
Deposits from customers	600
Certificates of deposit	(200)
Net cash from operating activities before income tax	3,440
Income taxes paid	(100)
Net cash from operating activities	3,340
Cash flows from investing activities	
Dividends received	250
Interest received	300
Proceeds from sales of permanent investments	1,200
Purchase of permanent investments	(600)
Purchase of fixed assets	(500)
Net cash from investing activities	650
Cash Flow Statements	39
Cash flows from financing activities	
Issue of shares	1,800
Repayment of long-term borrowings	(200)
Net decrease in other borrowings	(1,000)
Dividends paid	(400)
Net cash from financing activities	200
Net increase in cash and cash equivalents	4,190
Cash and cash equivalents at beginning of period	4,650
Cash and cash equivalents at end of period	8,840

7.4 SOURCES OF CASH

Sources of Cash can be internal as well as external:

Internal Sources. Cash from operations is the main internal source. The Net Profit shown by the Profit and Loss Account will have to be adjusted for non-cash items for finding out cash from operations. Some of these items are as follows:

(*i*) *Depreciation.* Depreciation does not result in outflow of cash and, therefore, net profit will have to be increased by the amount of depreciation or development rebate charged, in order to find out the real cash generated from operations.

(*ii*) *Amortization of intangible assets.* Goodwill, preliminary expenses, etc., when written off against profits, reduce the net profits without affecting the cash balance. The amounts written off should, therefore, be added back to profits to find out the cash from operations.

(*iii*) *Loss on sale of fixed assets.* It does not result in outflow of cash and, therefore, should be added back to profits.

(*iv*) *Gain from sale of fixed assets.* Since sale of fixed assets is taken as a separate source of cash, it should be deducted from net profits.

(*v*) *Creation of reserves.* If profit for the year has been arrived at after charging transfers to reserves, such transfers should be added back to profits. In case operations show a net loss, such net loss after making adjustments for non-cash items will be shown as an application of cash.

Thus, cash from operations is computed on the pattern of computation of 'Funds' from operations, as explained in the earlier chapter. However, to find out real cash from operations, adjustments will have to be made for 'changes' in current assets and current liabilities arising on account of operations, viz., trade debtors, trade creditors, bills receivable, bills payable, etc.

For the sake of convenience, computation of cash from operations can be studied by taking two different situations: (1) when all transactions are cash transactions, and (2) when all transactions are not cash transactions.

When All Transactions are Cash Transactions. The computation of cash from operations will be very simple in this case. The net profit as shown by the Profit and Loss Account will be taken as the amount of cash from operations as shown in the following example:

Example

PROFIT AND LOSS ACCOUNT
for the year ended 31 December 1998

Particulars	*Rs*	*Particulars*	*Rs*
To Purchases	15,000	By Sales	50,000
To Wages	10,000		
To Rent	500		
To Stationery	2,500		
To Net profit	22,000		
	50,000		50,000

In the example given above, if all transactions are cash transactions, i.e., all purchases have been paid for in cash and all sales have been realised in cash, the cash from operations will be Rs 22,000, i.e., the net profit as shown by the Profit and Loss Account. Thus, in case of all transactions being cash transactions, the equation for computing cash from operations can be put as follows:

$$\boxed{\text{Cash from Operations} = \text{Net Profit}}$$

When all transactions are not cash transactions. In the example given above, we have computed cash from operations on the basis that all transactions are cash transactions. It does not really happen in actual practice. The business sells goods on credit. It purchases goods on credit. Certain expenses are always outstanding and some of the incomes are not immediately realised. Under such circumstances, the net profit made by a firm cannot generate equivalent amount of cash. The computation of cash from operations in such a situation can be done conveniently if it is done in two stages:

(*i*) Computation of funds (i.e., working capital) from operations as explained in the preceding chapter; and

(*ii*) Adjustments in the funds so calculated for changes in the current assets (excluding cash) and current liabilities.

We are giving below an illustration for computing 'Funds' from operations. However, since there are no credit transactions, hence the amount of 'Funds' from operations is as a matter of cash from operations as shown in the illustration.

Illustration 7.1.

TRADING AND PROFIT AND LOSS ACCOUNT
for the year ended 31 March 1998

Particulars	*Rs*	*Particulars*		*Rs*
To Purchases	20,000	By Sales		30,000
To Wages	5,000			
To Gross Profit c/d	5,000			
	30,000			30,000
To Salaries	1,000	By Gross Profit b/d		5,000
To Rent	1,000	By Profit on sale of building:		
To Depreciation on Plant	1,000	Book value	Rs 10,000	
To Loss on sale of Furniture	500	Sold for	15,000	5,000
To Goodwill written off	1,000			
To Net Profit	5,500			
	10,000			10,000

NOTES

Check Your Progress

1. State whether each of the following statements is 'True' or 'False':

(a) Cash flow statement reveals the effects of transactions involving movement of cash.

(b) The term 'Funds' means 'Current Assets' in Case of a Cash Flow Analysis.

(c) A 'Cash Flow Statement' can very well be equated with an 'Income Statement'.

(d) A company should keep large balances of cash in hand so it can meet all contingencies.

(e) Increase in provision for doubtful debts should be added back in order to find out cash from operations.

(f) Funds flow statements and cash flow statements are one and the same.

NOTES

Calculate the Cash from Operations.

Solution:

CASH FROM OPERATIONS

	Net Profit as per P & L A/c		Rs 5,500
Add:	Non-cash items (i.e., items which do not result in outflow of cash):		
	Depreciation	Rs 1,000	
	Loss on sale of furniture	500	
	Goodwill written off	1,000	2,500
			8,000
Less:	Non-cash items (items which do not result inflow of cash):		
	Profit on sale of building		5,000
	(Rs 15,000 will be taken as a source of cash)		
	Cash from Operations		3,000

Adjustments for Changes in Current Assets and Current Liabilities

In the illustration given above, the cash from operations has been computed on the same pattern on which funds from operations are computed. As a matter of fact, the funds from operations is equivalent to cash from operations in this case. This is because of the presumption that all are cash transactions and all goods have been sold. However, there may be credit purchases, credit sales, outstanding and prepaid expenses, etc. In such a case, adjustments will have to be made for each of these items in order to find out cash from operations. This has been explained in the following pages:

(*i*) *Effects of Credit Sales.* In business, there are both cash sales and credit sales. In case, the total sales are Rs 30,000 out of which the credit sales are Rs 10,000, it means sales have contributed only the extent of Rs 20,000 in providing cash from operations. Thus, while computing cash from operations, it will be necessary that suitable adjustments for outstanding debtors are also made. Consider the following example:

Example 1

Net Profit for the year	Rs 20,000
Total Sales	40,000
Debtors Outstanding at the end of the accounting year	10,000

The above figures show that out of total sales of Rs 40,000 which must have been considered from computing net profit, Rs 10,000 has still to be realised in cash from debtors. Therefore, cash from operations should be computed as follows:

Net Profit for the year		Rs 20,000
Less:	Debtors Outstanding at the end of the accounting year	10,000
	Cash from Operations	10,000

In case, there were outstanding debtors in the beginning of the accounting year amounting to Rs 15,000, it can safely be presumed that they must have been realised during the course of the year. The amount of cash from operations will therefore be computed as follows:

Net Profit for the year	Rs 20,000
Less: Debtors Outstanding at the end of the accounting year	10,000
	10,000
Add: Debtors Outstanding at the end of the accounting year	15,000
Cash from operations	25,000

Thus, cash from operations can be calculated on the basis of the following equation if there are debtors outstanding at the end as in the beginning of the accounting year:

NOTES

Cash from Operations = Net Profit	+	Debtors Outstanding at the beginning of the accounting year.
		Or
	–	Debtors Outstanding at the end of the accounting year.

Or

Cash from Operations = Net Profit	+	Decrease in Debtors.
		Or
	–	Increase in Debtors

For example, in the above case, cash from operations can be computed as follows:
Rs 20,000 + Rs 5,000 = Rs 25,000

(*ii*) *Effects of Credit Purchases.* Whatever have been stated regarding credit sales is also applicable to credit purchases. The only difference will be that decrease in creditors from one period to another will result in decrease of cash from operations because it means more cash payments have been made to the creditors which will result in outflow of cash. On the other hand, increase in creditors from one period to another will result in increase of cash from operations because less payment has been made to the creditors for goods supplied which will result in increase of cash balance at the disposal of the business.

Example 2

Purchases for the year (including credit purchases of Rs 10,000)	Rs 30,000
Sales for the year	40,000
Expenses	5,000

The amount of Net Profit comes to:

Sales			40,000
Less:	Purchases	Rs 30,000	
	Expenses	5,000	35,000
Net Profit			5,000

Though the net profit is Rs 5,000, the cash operations will be Rs 15,000 (Rs 5,000 + Rs 10,000 for credit purchases). This is because though Purchases of Rs 30,000 have been considered for calculating the Net Profit, the actual cash which has been paid for purchases is only Rs 20,000. Thus, cash from operations stands increased by Rs 10,000, the amount of creditors outstanding at the end of the year.

Example 3

Sales			Rs 40,000
Purchases			30,000
Expenses			5,000
Creditors Outstanding in the beginning of the accounting year			10,000
Creditors Outstanding at the end of the accounting year			15,000
The Cash from Operations will be computed as follows:			
Sales			40,000
Less:	Purchases	Rs 30,000	
	Expenses	5,000	35,000
Net Profit			5,000
Add: Creditors Outstanding at the end of the accounting year			15,000
			20,000
Less: Creditors Outstanding at the beginning of the accounting year			10,000
Cash from operations			10,000
Alternatively, cash from operations can be computed as follows:			
Net Profit for the year			Rs 5,000
Add: Increase in Creditors (Rs 15,000 – Rs 10,000)			5,000
Cash from Operations			10,000

Thus, the effect of credit purchases can be shown with the help of the following equation in computing cash from operations:

NOTES

Cash from Operations = Net Profit	+ Increase in Creditors *Or* – Decreases in Creditors

(iii) *Effect of Opening and Closing Stocks.* The amount of opening stock is charged to the debit side of the Profit and Loss Account. It thus reduces the net profit without reducing the cash from operations. Similarly, the amount of closing stock is put on the credit side of the Profit and Loss Account. It thus increases the amount of net Profit without increasing the cash from operations. This will be clear with the help of the following example:

Example 4

Opening Stock	Rs 5,000
Purchases	20,000
Sales	35,000
Closing Stock	10,000
Expenses	5,000

The amount of net profit can be computed as follows:

PROFIT AND LOSS ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
Opening Stock	5,000	Sales	35,000
Purchases	20,000	Closing Stock	10,000
Expenses	5,000		
Net Profit	15,000		
	45,000		45,000

The net profit for the year is Rs 15,000. The cash from operations will be computed as follows:

Net Profit for the year	Rs 15,000
Add: Opening Stock	5,000
	20,000
Less: Closing Stock	10,000
Cash from Operations	10,000

Alternatively, the amount of cash from operations can be computed as follows:

Net Profit for the year	Rs 15,000
Less: Outflow of cash on account of increase in stock	5,000
Cash from Operations	10,000

The effect of change in stock on cash from operations can now be put up as follows:

Cash from Operations = Net Profit	+ Decrease in Stock *Or* – Increase in Stock

(iv) *Effect of Outstanding Expenses, Incomes Received in Advance, etc.* The effect of these items on cash from operations is similar to the effect of creditors. This means any increase in these items will result in increase in cash from operations while any decrease means decrease in cash from operations. This is because net profit from operations is computed after charging to it all expenses whether paid or outstanding. In case certain expenses have not been paid, this will result in decrease of net profit without a corresponding decrease in cash from operations. Similarly, income received in advance is not taken into account while calculating profit from operations, since it relates to the next year. It, therefore, means cash from operations will be higher than the actual net profit as shown by the Profit and Loss Account. Consider the following example:

NOTES

Example 5

Gross Profit	Rs 30,000
Expenses paid	Rs 10,000
Interest received	Rs 2,000

Rs 2,000 are outstanding on account of expenses while Rs 500 has been received as interest for the next year. The net profit will be computed as follows:

PROFIT AND LOSS ACCOUNT

Particulars		*Rs*	*Particulars*		*Rs*
To Expenses paid	10,000		By Gross Profit		30,000
Add. Outstanding	2,000	12,000	By Interest received	2,000	
To Net Profit		19,500	*Less:* Interest received		
			in advance	500	1,500
		31,500			31,500

The cash from operations will now be computed as follows:

	Rs
Net Profit for the year	19,500
Add: Expenses Outstanding at the end of the year	2,000
Interest received in advance	500
Cash from Operations	22,000

Example 6

Net Profit for the year 1993	10,000
Expenses Outstanding as on 1 January, 1993	2,000
Expenses Outstanding as on 31 December, 1993	3,000
Interest received in Advance 1 January, 1993	1,000
Interest received in Advance 32 December, 1993	2,000

The cash from operations will be computed as follows:

Net Profit for the year		10,000
Add: Expenses Outstanding on 31 December, 1993		3,000
Income received in Advance on 31 December, 1993		2,000
		15,000
Less: Expenses Outstanding on 1 January, 1993	Rs 2,000	
Interest received in Advance on 1 January, 1993	1,000	3,000
Cash from Operations		12,000

Alternatively, cash operations can be computed as follows:

Net Profit for the year	Rs 10,000
Add: Increase in Outstanding Expenses	1,000
Add: Increase in interest received in Advance	1,000
Cash from Operations	12,000

Thus, the income received in advance and outstanding expenses on cash operations can be shown as follows:

Cash from Operations = Net Profit
+ Increase in Outstanding Expenses
+ Increase in Income received in Advance
– Decrease in Outstanding Expenses
– Decrease in Income received in Advance

(v) *Effect of Prepaid Expenses and Outstanding Income.* The effect of prepaid expenses and outstanding income of cash from operations is similar to the effect of debtors. While computing net profit from operations, the expenses only for the accounting year are charged to the Profit and Loss Account. Expenses paid in advance are not charged to the Profit and Loss Account. Thus, prepayment of expenses does not decrease net profit for the year but it decreases cash from operations. Similarly, income earned during a year is credited to the Profit and Loss Account whether it has

Check Your Progress

2. Choose the correct answer:
   (*i*) Cash from operations is equal to:
   (*a*) Net profit plus increase in outstanding expenses
   (*b*) Net profit plus increase in debtors,
   (*c*) Net profit plus increase in stock.
   (*ii*) Increase in the amounts of debtors results in:
   (*a*) Decrease in cash,
   (*b*) Increase in cash,
   (*c*) No change in cash.
   (*iii*) Increase in the amount of bills payable results in:
   (*a*) Increase in cash,
   (*b*) Decrease in cash,
   (*c*) No change in cash.

NOTES

been received or not. Thus, income, which has not been received but which has become due, increase the net profit for the year without increasing cash from operations. This will be clear with the help of the following example:

Example 7

Gross Profit	Rs 30,000
Expenses paid	10,000
Interest received	2,000

The expenses paid include Rs 1,000 paid for the next year. While interest of Rs 500 has become due during the year, but it has not been received so far. The net profit for the year will be computed as follow:

PROFIT AND LOSS ACCOUNT

Particulars		*Rs*	*Particulars*		*Rs*
To Expenses paid	10,000		By Gross Profit		30,000
Less: Prepaid Exp.	1,000	9,000	By Interest received	2,000	
To Net Profit		23,500	*Add*: Interest due	500	2,500
		32,500			32,500

Now, the cash from operations will be computed as follows:

Net Profit for the year		Rs 23,500
Less: Prepaid Expenses	1,000	
Less: Outstanding Interest	500	15,00
		22,000

Example 8

Net Profit for the year 1993	20,000
Prepaid expenses 1 January, 1993	2,000
Outstanding (accrued) Income 1 January, 1993	1,000
Prepaid Expenses 31 December, 1993	3,000
Outstanding Income 31 December, 1993	2,000

Cash from Operations will be computed as follows:

Net Profit for the year		Rs 20,000
Less: Prepaid Expenses on 31 Dec., 1993	3,000	
Outstanding Income on 31 Dec., 1993	2,000	5,000
		15,000
Add: Prepaid Expenses on 1 Jan., 1993	2,000	
Income Outstanding on 1 Jan., 1993	1,000	3,000
		18,000

Alternatively, Cash from Operations can be computed as follow:

Net Profit for the year		Rs 20,000
Less: Increase in Prepaid Expenses	Rs 1,000	
Increase in Outstanding Income	1,000	2,000
		18,000

Thus the effect of prepaid expenses and accrued income on cash from operations can be shown in the form of following equation:

Cash from Operations = Net Profit	+ Decrease in Prepaid Expenses + Decrease in Accrued Income – Increase in Prepaid Expenses – Income in Accrued Income

The overall effect of stock, debtors, creditors, outstanding expenses, income received in advance, prepaid expenses and accrued can be shown in the form of the following formula:

NOTES

Cash from Operations = Net Profit	+ Decrease in Debtors + Decrease in Stock + Decrease in Prepaid Expenses + Decrease in Accrued Income + Increase in Creditors + Increase in Outstanding Expenses – Increase in Debtors – Increase in Stock – Increase in Prepaid Expenses – Increase in Accrued Income – Decrease in Creditors – Decrease in Outstanding Expenses

The above formula may be summarised in the form of following general rules:

Increase in a Current Asset
Decrease in a Current Liability
results in
Decrease in Cash

AND

Decrease in a Current Asset
Increase in a Current Liability
results in
Increase in Cash

Illustration 7.2 Continuing the figures given as Illustration 7.1 calculate the cash from operations with the following additional information:

Balance as on

	31 March, 1994 Rs	*31 March 1995 Rs*
(*i*) Stocks	10,000	12,000
(*ii*) Debtors	15,000	20,000
(*iii*) Creditors	5,000	7,500
(*iv*) Bills Receivable	5,000	8,000
(*v*) Outstanding Expenses	3,000	5,000
(*vi*) Bills Payable	4,000	2,000
(*vii*) Prepaid Expenses	1,000	500

Solution:

The computation of cash from operations can be done conveniently if it is done as explained before in two stages:

(*i*) Computation of 'Funds' from operations, taking the meaning of 'Funds' as working capital.

(*ii*) Adjustment in the amount of 'Funds' so computed on the basis of 'current assets' and 'current liabilities'.

The funds from operations amount Rs 3,000 (as computed in Illustration 7.1).

However, adjustments will have to be made in this amount for current assets and current liabilities in order to compute cash from operations. This has to be done by taking each item of current assets and current liabilities independently as explained below:

(*i*) The investment in stock has increased by Rs 2,000 as compared to the previous year. This means cash must gone out to the extent of Rs 2,000. It will, therefore, decrease the cash balance.

(*ii*) Debtors have gone up from Rs 15,000 on March, 1994 to Rs 20,000 on 31 March, 1995. There is an increase of Rs 5,000. It shows that sales to the of Rs 5,000 have not been realised in cash. Hence, cash from operations will be reduced by Rs 5,000.

(*iii*) Creditors have gone up by Rs 2,500. Thus, purchases to the extent of this amount have not been paid in cash. It is, therefore, a 'source' of cash.

NOTES

(*iv*) Bills Receivable have increased by Rs 3,000. Thus, sales to the extent of Rs 3,000 have not been paid in cash. Hence cash, on account of operations will be reduced by Rs 3,000.

(*v*) Bills Payable have come down by Rs 2,000. It shows more payments of cash. The cash from operations will stand reduced by Rs 2,000.

(*vi*) Outstanding Expenses have increased by Rs 2,000. Thus, expenses to this extent have not been paid resulting in increase of cash from operations by this amount.

(*vii*) Prepaid Expenses have come down by Rs 500. This shows less of payment and hence cash operations will increase by Rs 500.

Cash from operations now can be computed as follows:

	Increase (+)	*Decrease* (–)	
Cash from Operations as per P. & L. A/c (Illustration 7.1)			Rs 3,000
Increase in Stock		2,000	
Increase in Debtors		5,000	
Increase in Creditors		2,500	
Increase in Bills Receivable		3,000	
Decrease in Bills Payable		2,000	
Increase in Outstanding Expenses	2,000		
Decrease in Prepaid Expenses	500		
	5,000	12,000	(7,000)
(Inflow) of cash on account of operations			(4,000)

External Sources. The external sources of cash are:

(*i*) *Issue of New Shares.* In case shares have been issued for cash, the net cash received (i.e., after deducting expenses on issue of shares or discount on issue of shares) will be taken as a source of cash.

(*ii*) *Raising Long-term Loans.* Long-term loans such as issue of debentures, loans from Industrial Finance Corporations, State Financial Corporation, IDBI, etc., are sources of cash. They should be shown separately.

(*iii*) *Purchase of Plant and Machinery on deferred payments.* In case plant and machinery has been purchased on a deferred payment system, it should be shown as a separate source of cash to the extent of deferred credit. However, the cost of machinery purchased will be shown as an application of cash.

(*iv*) *Short-term Borrowings—cash credit from banks.* Short-term borrowing, etc., from banks increase cash available and they have to be shown separately under this head.

(*v*) *Sale of Fixed Assets, Investments, etc.* It results in generation of cash and therefore, is, a source of cash.

Decrease in various current assets and increase in various current liabilities (discussed before) may be taken as external sources of cash, if they are not adjusted while computing cash from operations.

Applications of Cash

Applications of cash may take any of the following forms:

(*i*) *Purchase of Fixed Assets.* Cash may be utilised for additional fixed assets or renewals or replacement of existing fixed assets.

NOTES

(*ii*) *Payment of Long-term Loans.* The payment of long-term loans such as loans from financial institutions or debentures results in decrease in cash. It is, therefore, an application of cash.

(*iii*) *Decrease in Deferred Payment Liabilities.* Payments for plant and machinery purchased on deferred payment basis has to be made as per the agreement. It is, therefore, an application of cash.

(*iv*) *Loss on account of Operations.* Loss suffered on account of business operations will result in outflow of cash.

(*v*) *Payment of Tax.* Payment of tax will result in decrease of cash and hence it is an application of cash.

(*vi*) *Payment of Dividend.* This decreases the cash available for business and hence it is an application of cash.

(*vii*) *Decrease in Unsecured Loans, Deposits, etc.* The decrease in these liabilities denotes they have been paid off to that extent. It results, therefore, in outflow of cash.

Increase in various current assets or decrease in various current liabilities may be shown as applications of cash, if changes, in these items have not been adjusted while finding out cash from operations.

Format of A Cash Flow Statemeny†

A cash flow statement can be prepared in the following form:

CASH FLOW STATEMENT
for the year ending on....

Balance as on 1 January, ...		
Cash Balance	....	
Bank Balance	....	....
Add: Sources of Cash:	____	
Issue of Shares		....
Raising of Long-term loans		
Sale of Fixed Assets		....
Short-term Borrowings		
Cash from Operations:		
Profit as per Profit and Loss A/c	....	
Add/Less: Adjustment for Non-cash Items	....	
Add: Increase in Current Liabilities	....	
Decrease in Current Assets	....	
Less: Increase in current assets	....	
Decrease in current liabilities	....	....
Total Cash available (1)	____	____
Less: Applications of Cash:	....	....
Redemption of Redeemable Preference Shares		
Redemption of Long-term Loans	....	
Purchase of Fixed Assets	....	
Decrease in Deferred Payment Liabilities	....	
Cash Outflow on Account of Operations	....	
Tax paid	....	
Dividend paid	....	
Decrease in unsecured Loans, Deposits, etc.	....	
Total Applications (2)	____	
Closing Balance*		....
Cash balance		....
Bank balance		....

* It should tally with the balance as shown by (1)–(2).

† The format given above has undergone a change as per AS-3 discussed later in the book.

7.5 DIFFERENCE BETWEEN CASH FLOW ANALYSIS AND FUNDS FLOW ANALYSIS

NOTES

Following are the points of difference between a Cash Flow Analysis and a Funds Flow Analysis:

1. A Cash Flow Analysis is concerned only with the change in cash position while a Fund Flow Analysis is concerned with change in working capital position, between two balance sheet dates. Cash is only one of the constituents of working capital besides several other constituents such as inventories, accounts receivable, prepaid expenses.
2. A Cash Flow Statement is merely a record of cash receipts and disbursements. Of course, it is valuable in its own way but it fails to bring to light many important changes involving the disposition of resources. While studying the short-term solvency of a business one is interested not only in cash balance but also in the assets which can be easily converted into cash.
3. Cash flow analysis is more useful to the management as a tool of financial analysis in short-periods as compared to funds flow analysis. It has rightly been said that the shorter the period covered by the analysis, the greater is the importance of cash flow analysis. For example, if it is to be found out whether the business can meet its obligations maturing after 10 years from now, a good estimate can be made about the firm's capacity to meet its long-term obligations if changes in working capital position on account of operations are observed. However, if the firm's capacity to meet a liability maturing after one month is to be seen, the realistic approach would be to consider the projected change in the cash position rather than an expected change in the working capital position.
4. Cash is part of working capital and, therefore, an improvement in cash position results in improvement in the funds position but the reverse is not true. In other words 'inflow of cash' results in 'inflow of funds' but inflow of funds may not necessarily result in 'inflow of cash'. Thus, a sound funds position does not necessarily means a sound cash position but a sound cash position generally means a sound funds position.
5. Another distinction between a cash flow analysis and a funds flow analysis can be made on the basis of the techniques of their preparation. An increase in a current liability or decrease in a current asset results in decrease in working capital and vice versa. While an increase in a current liability or decrease in a current asset (other than cash) will result in increase in cash and vice versa.

Some people, use the term 'funds' in a very narrow sense of 'cash' only. In such an event the two terms 'Funds' and 'Cash' will have synonymous meanings.

7.6 UTILITY OF CASH FLOW ANALYSIS

A Cash Flow Statement is useful for short-term planning. A business enterprise needs sufficient cash to meet its various obligations in the near future such as payment for purchase of fixed assets, payment of debts maturing in the near future, expenses of the business, etc. A historical analysis of the different sources and applications of cash will enable the management to make reliable cash flow projections for the immediate future. It may then plan for investment of surplus or meeting the deficit, if any. Thus, a cash flow analysis is an important financial tool for the management. Its chief advantages are as follows:

NOTES

1. **Helps in efficient cash management.** Cash flow analysis helps in evaluating financial policies and cash position. Cash is the basis for all operations and hence a projected cash flow statement will enable the management to plan and coordinate the financial operations properly. The management can know how much cash is needed, from which source it will be derived, how much can be generated internally and how much could be obtained from outside.

2. **Helps in internal financial management.** Cash flow analysis provides information about funds which will be available from operations. This will help the management in determining policies regarding internal financial management, e.g., possibility of repayment of long-term debts, dividend policies, planning replacement of plant and machinery, etc.

3. **Discloses the movements of cash.** Cash flow statement discloses the complete story of cash movement. The increase in or decrease of cash and the reasons can therefore be known. It discloses the reasons for low cash balance in spite of heavy operating profits or for heavy cash balance in spite of low profits. However, comparison of original forecast with the actual results highlights the trends of movements of cash which may otherwise go undetected.

4. **Discloses success or failure of cash planning.** The extent of success or failure of cash planning can be known by comparing the projected cash flow statement with the actual cash flow statement and necessary remedial measures can be taken.

7.7 LIMITATIONS OF CASH FLOW ANALYSIS

Cash flow analysis is a useful tool of financial analysis. However, it has its own limitations. These limitations are as under:

1. Cash flow statement cannot be equated with the Income Statement. An Income Statement takes into account both cash as well as non-cash items and, therefore, net cash does not necessarily mean net income of the business.
2. The cash balance as disclosed by the cash flow statement may not represent the real liquid position of the business since it can be easily influenced by postponing purchases and other payments.
3. Cash flow statement cannot replace the Income Statement or the Funds Flow Statement. Each of them has a separate function to perform.

In spite of these limitations it can be said that cash flow statement is a useful supplementary instrument. It discloses the volume as well as the speed at which the cash flows in the different segments of the business. This helps the management in knowing the amount of capital tied up in a particular segment of the business. The technique of cash flow analysis, when used in conjunction with ratio analysis, serves as a barometer in measuring the profitability and financial position of the business.

The concept and technique of preparing a Cash Flow Statement will be clear with the help of illustrations given in the following pages.

NOTES

Cash from Operations

Illustration 7.3. From the following balances you are required to calculate cash from operations:

	31 December 1993 Rs	31 December 1994 Rs
Debtors	50,000	47,000
Bills Receivable	10,000	12,500
Creditors	20,000	25,000
Bills Payable	8,000	6,000
Outstanding Expenses	1,000	1,200
Prepaid Expenses	800	700
Accrued Income	600	750
Income received in advance	300	250
Profit made during the year	—	1,30,000

Solution:

CASH FROM OPERATIONS

Particulars	*Rs.*	*Rs.*
Profit made during the year		1,30,000
Add: Decrease in Debtors	3,000	
Increase in Creditors	5,000	
Increase in Outstanding Expenses	200	
Decrease in Prepaid Expenses	100	8,300
		1,38,300
Less: Increase in Bills Receivable	2,500	
Decrease in Bills Payable	2,000	
Increase in Accrued Income	150	
Decrease in Income received in Advance	50	4,700
Cash from Operations		1,33,600

Illustration 7.4. Statement of financial position of Mr. Arun is given below:

Liabilities Rs	*1 Jan.,1998* Rs	*31 Dec.,1998*	*Assets* Rs	*1 Jan., 1998* Rs	*31 Dec.,1998*
Accounts Payable	29,000	25,000	Cash	40,000	30,000
Capital	7,39,000	6,15,000	Debtors	20,000	17,000
			Stock	8,000	13,000
			Building	1,00,000	80,000
			Other Fixed Assets	6,00,000	5,00,000
	7,68,000	6,40,000		7,68,000	6,40,000

Additional Information

(*a*) There were no drawings.

(*b*) There were no purchases or sales of either building or other fixed assets. Prepare a Statement of Cash Flow.

Solution:

CASH FLOW STATEMENT

Cash Balance as on 1 January, 1993		Rs 40,000
Net Loss as per Profit and Loss A/c:		
Capital at the end of 1993	6,15,000	
Less: Capital at the beginning of 1993	7,39,000	
	(1,24,000)	

(*Contd.*)

NOTES

Add: Non-cash Charges:			
Depreciation on Buildings	20,000		
Depreciation on other Fixed Assets	1,00,000	1,20,000	
Funds from Operations		(4,000)	
Add: Decrease in Current Assets:			
Debtors		3,000	
		(1,000)	
Less: Increase in Current Assets or Decrease in Current Liabilities:			
Increase in Stocks	5,000		
Decrease in Accounts Payable	4,000	(9,000)	
Cash Outflow on account of operations			(10,000)
Cash Balance as on 31 December, 1993			30,000

7.8 AS 3 (REVISED): CASH FLOW STATEMENTS[1]

The following are the salient features of the Revised Accounting Standard (AS) 3, Cash Flow Statements, issued by the Council of the Institute of Chartered Accountants of India in March 1997. This Standard supersedes AS 3, Changes in Financial Position, issued in June, 1981.

The standard has been mandatory for all enterprises from accounting period commencing or after 1.4.2001.

1. Objectives

Information about the cash flows of an enterprise is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and needs of the enterprise to utilise those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an enterprise to generate cash and cash equivalents and the timings and certainty of their generation.

The Statement deals with the provisions of information about the historical changes in cash and cash equivalents of an enterprise by means of a cash flow statement which classifies cash flows during the period from operating, investing and financing activities.

2. Scope

(1) An enterprise should prepare a cash flow statement and should present it for each period for which financial statements are presented.

(2) Users of an enterprise's financial statements are interested in how the enterprise generates and uses cash and cash equivalents. This is the case regardless of the nature of the enterprise's activities and irrespective of whether cash can be viewed as the product of the enterprise, as may be the case with a financial enterprise. Enterprises need cash for essentially the same reasons, however different their principal revenue-producing activities might be. They need cash to conduct their operations, to pay their obligations, and to provide returns to their investors.

3. Benefits of Cash Flow Information

(1) A cash flow statement, when used in conjunction with the other financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency), and its ability to affect the amounts and timing of cash

[1] *The Chartered Accountant*, March, 1997, p. 68.

flows in order to adapt to changing circumstances and opportunities. Cash flow information is useful in assessing the ability of the enterprise to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different enterprises.

NOTES

(2) It also enhances the comparability of the reporting of operating performance by different enterprise because it eliminates the effects of using different accounting treatments for the same transactions and events.

(3) Historical cash flow information is often used as an indicator of the amount, timing and certainty of future cash flows. It is also useful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and the impact of changing prices.

4. Definitions

The following terms are used in this Statement with the meanings specified:

(1) *Cash* comprises cash on hand and demand deposits with banks.

(2) *Cash equivalents* are short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

(3) *Cash flows* are inflows and outflows of cash and cash equivalents.

(4) *Operating activities* are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.

(5) *Investing activities* are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

(6) *Financing activities* are activities that result in changes in the size and composition of the owner's capital (including preference share capital in the case of a company) and borrowings of the enterprise.

5. Presentation of A Cash Flow Statement

The cash flow statement should report cash flows during the period classified by operating investing and financing activities.

(1) **Operating activities.** Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the enterprise. Therefore, they generally result from the transactions and other events that enter into the determination of net profit or loss. Examples of cash flows from operating activities are:

(*a*) cash receipts from the sale of goods and the rendering of services;

(*b*) cash receipts from royalties, fees, commissions, and other revenue;

(*c*) cash payments to suppliers for goods and services;

(*d*) cash payments to and on behalf of employees;

(*e*) cash receipts and cash payments of an insurance enterprise for premiums and claims, annuities and other policy benefits;

(*f*) cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and

(*g*) cash receipts and payments relating to future contracts, forward contracts, option contracts and swap contracts when the contracts are held for dealing or trading purposes.

NOTES

(2) **Investing activities.** Examples of cash flows arising from investing activities are:

(*a*) cash payments to acquire fixed assets (including intangibles). These payments include those relating to capitalised research and development costs and self-constructed fixed assets;

(*b*) cash receipts from disposal of fixed assets (including intangibles);

(*c*) cash payments to acquire shares, warrants, or debt instruments of other enterprises and interests in joint ventures (other than payments for those instruments considered to be cash equivalents and those held for dealing or trading purposes);

(*d*) cash receipts from disposal of shares, warrants, or debt instruments of other enterprises and interests in joint ventures (other than receipts from those instruments considered to be cash equivalents and those held for dealing or trading purposes);

(*e*) cash advances and loans made to third parties (other than advances and loans made by financial enterprise);

(*f*) cash receipts from the repayment of advances and loans made to third parties (other that than advances and loans of a financial enterprise);

(*g*) cash payments for future contracts, forward contracts, option contracts, and swap contract except when the contracts are held for dealing or trading purposes, or the payments and classified as financing activities; and

(*h*) cash receipts from future contracts, forward contracts, option contracts, and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

(3) **Financing activities.** Examples of cash flows arising from financing activities are:

(*a*) cash proceeds from issuing shares or other similar instruments;

(*b*) cash proceeds from issuing debentures, loans, notes, bonds, and other short- or long-term borrowings; and

(*c*) cash repayments of amounts borrowed.

Reporting Cash Flows from Investing and Financing Activities

An enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraph 6 are reported on a net basis.

6. Reporting Cash Flows on A Net Basis

(1) Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:

(*a*) cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the enterprise.

Examples of cash receipts and payments referred to above are as follows:

(*a*) the acceptance and repayment of demand deposits by a bank;

(*b*) funds help for customers by an investment enterprise; and

(*c*) rents collected on behalf of, and paid over to, the owners of properties.

(*d*) cash receipts and payments for items in which the turnover is quick, the amounts large, and the maturities are short.

NOTES

Examples of cash receipts and payments referred above are advances made for, and the repayments of:

(*a*) Principal amounts relating to credit card customers;

(*b*) the purchase and sale of investments; and

(*c*) other short-term borrowings, for example, those which have a maturity period of three months or less.

(2) Cash flows arising from each of the following activities of a financial enterprise may be reported on a net basis:

(*a*) cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;

(*b*) the placement of deposits with and withdrawal of deposits from other financial enterprises; and

(*c*) cash advances and loans made to customers and the repayment of those advances and loans.

7. Disclosure

(1) **Components of cash and cash equivalents**. An enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.

(2) **Other disclosures**. An enterprise should disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the enterprise that are not available for use by it.

Note. As a result of AS: 3 (Revised) discussed above, the presentation of a Cash Flow Statement has undergone a change. In the following pages, illustration involving presentation of Cash Flow Statement cash by the Traditional Approach and Modern Approach as per AS: 3 (Revised) are given.

The students should prepare cash flow statement as per AS : 3 (Revised). We have given traditional approach only for making the subject more intelligible.

Comprehensive Cash Flow Statements

Illustration 7.5. Balance Sheet of *A* and *B* on 1 January, 1993 and 31 December, 1993 were as follows:

BALANCE SHEET

Liabilities	*1 Jan., 1993 Rs*	*31 Dec.,1993 Rs*	*Assets*	*1 Jan., 1993 Rs*	*31 Dec., 1993 Rs*
Creditors	40,000	44,000	Cash	10,000	7,000
Mrs. *A*'s Loan	25,000	—	Debtors	30,000	50,000
Loans from Bank	40,000	50,000	Stock	35,000	25,000
Capital	1,25,000	1,53,000	Machinery	80,000	55,000
			Land	40,000	50,000
			Building	35,000	60,000
	2,30,000	2,47,000		2,30,000	2,47,000

During the year a machine costing Rs 10,000 (accumulated depreciation Rs 3,000) was sold for Rs 5,000. The provisions depreciation against Machinery as on 1 January, 1993 was Rs 25,000 and on 31 December, 1993 was Rs 40,000. Net profit for the year 1993 amount to Rs 45,000. You are required to prepare a Cash Flow Statement.

NOTES

Solution:

(*i*) **Traditional Approach**

CASH FLOW STATEMENT

		Rs
Cash Balance as on January, 1993		10,000
Add: Sources:		
Cash from Operations	59,000	
Loan from Bank	10,000	
Sale of Machinery	5,000	74,000
		84,000
Less: Applications:		
Purchase of Land	10,000	
Purchase of Building	25,000	
Mrs. *A*'s Loan repaid	25,000	
Drawings	17,000	77,000
Cash balance as on 31 Dec., 1993		7,000

Working Notes

Cash from Operations		Rs
Profit made during the year		45,000
Add: Depreciation on Machinery	18,000	
Loss on sale of Machinery	2,000	
Decrease in Stock	10,000	
Increase in Creditors	4,000	34,000
		79,000
Less: Increase in Debtors		20,000
Cash from Operations		59,000

MACHINERY ACCOUNT (AT COST)

Particulars	*Rs*	*Particulars*	*Rs*
To Balance b/d	1,05,000	By Bank	5,000
		By Loss on sale of Machinery	2,000
		By Provision for Depreciation	3,000
		By Balance c/d	95,000
	1,05,000		1,05,000

PROVISION FOR DEPRECIATION

Particulars	*Rs*	*Particulars*	*Rs*
To Machinery A/c	3,000	By Balance b/d	25,000
To Balance c/d	40,000	By P. and L. A/c (deprn. charged—balancing figure)	18,000
	43,000		43,000

(*ii*) **Modern Approach**

CASH FLOW STATEMENT

		Rs
Net Cash Flows from Operating Activities		59,000
Cash flows from Investing Activities:		
Sale of Machinery	5,000	
Purchase of Land	(10,000)	
Purchase of Building	(25,000)	
Net Cash flows from Investing Activities		(30,000)
Cash flows from Financing Activities:		
Loan from Bank	10,000	
Mrs. *A*'s Loan repaid	(25,000)	
Drawings	(17,000)	
Net Cash Flow from Financial Activities		32,000
Net Increase (Decrease) in cash and cash equivalents		3,000
Cash and Cash Equivalents on Jan. 1, 1993		10,000
Cash and Cash Equivalents on Dec. 31, 1993		7,000

NOTES

Illustrations 7.6. The following is the summarised Balance Sheet of a company as on December, 1992 and 1993:

Liabilities	*1992 Rs*	*1993 Rs*	*Assets*	*1992 Rs*	*1993 Rs*
Share Capital	2,00,000	2,50,000	Land and buildings	2,00,000	1,90,000
General Reserve	50,000	60,000	Machinery	1,50,000	1,69,000
Profit and loss	30,500	30,600	Stock	1,00,000	74,000
Bank loan (Long-term)	70,000	—	Sundry Debtors	80,000	64,200
Sundry creditors	1,50,000	1,35,200	Cash	500	600
Provision for taxation	30,000	35,000	Bank	—	8,000
			Goodwill	—	5,000
	5,30,500	5,10,800		5,30,500	5,10,800

Additional Information

During the year ended 31 December, 1993:

1. Dividend of Rs 23,000 was paid.
2. Assets of another company were purchased for a consideration of Rs 50,000 payable
in shares.

The following assets were purchased: Stock Rs 20,000: Machinery Rs 25,000.

3. Machinery was further purchased for Rs 8,000.
4. Depreciation written off machinery Rs 12,000.
5. Income tax provided during the year Rs 33,000.
6. Loss on sale of machinery Rs 200 was written off to General Reserve.

You are required to prepare a cash flow statement.

Solution:

(*i*) **Traditional Approach**

CASH FLOW STATEMENT

for the year ending 31 December, 1993

Particulars		*Rs*
Cash Balance as on 1 Jan., 1993		500
Add: Sources of Cash:		
Sale of Machinery		1,800
Cash from Operations		
Funds from Operations	88,300	
Add: Decrease in Stock	46,000	
Decrease in Debtors	15,800	
	1,50,100	
Less: Decrease in Creditors	14,800	1,35,300
		1,37,600
Less: Applications of Cash:		
Payment of Dividend	23,000	
Purchase of Machinery	8,000	
Tax paid (See Note 4)	28,000	
Mortgage Loan repaid	70,000	1,29,000
Closing Cash and Bank Balances		8,600
(Cash in hand Rs 600 + Cash at Bank Rs 8,000)		

Working Notes

1. ADJUSTED PROFIT LOSS ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Dividend	23,000	By Balance b/d	30,500
To Depreciation on Building	10,000	By Funds from Operations	
To Provision for Tax	33,000	(balancing figure)	88,300

(*Contd.*)

To Transfer to General Reserve	10,200		
To Deprn. on Machinery	12,000		
To Balance c/d	30,600		
	1,18,800		1,18,800

NOTES

2. MACHINERY ACCOUNT

Particulars	Rs	Particulars	Rs
To Balance b/d	1,50,000	By Depreciation	12,000
To Share Capital	25,000	By General Reserve	200
To Bank	8,000	By Bank	1,800
		By Balance c/d	1,69,000
	1,83,000		1,83,000

3. GENERAL RESERVE

Particulars	Rs	Particulars	Rs
To Machinery A/c	200	By Balance b/d	50,000
To Balance c/d	60,000	By P & L b/d	10,200
	60,200		60,200

4. PROVISION FOR TAXATION

Particulars	Rs	Particulars	Rs
To Bank	28,000	By Balance b/d	30,000
To Balance c/d	35,000	By P. & L. A/c	33,000
	63,000		63,000

5. DECREASE IN STOCK

	Rs
Stock as on December, 1992	1,00,000
Less: Stock as on December, 1993	54,000
(after deducting stock purchased by issuing share)	
Increase in Cash	46,000

(*ii*) **Modern Approach as per AS: 3 (Revised)**

CASH FLOW STATEMENT

for the ending 31 December, 1993

Particulars		Rs
Cash Flows Operating Activities:		
Funds from operations	88,300	
Adjustments for:		
Decrease in Stock	46,000	
Decrease in Debtors	15,800	
Decrease in Creditors	(14,800)	
Tax paid	28,000	
Net Cash from Operating Activities		1,07,300
Cash Flows Investing Activities:		
Sale of Machinery	1,800	
Purchase of Machinery	(8,000)	
Net Cash used for Investing Activities		(6,200)
Cash Flows from Financing Activities		
Payment of Dividend	(23,000)	
Mortgage Loan repaid	(70,000)	
Net Cash used in Financing Activities		(93,000)
Net Increase in Cash and Cash Equivalents		8,100
Cash and Cash Equivalents as on 1st Dec., 1993		500
Cash and Cash Equivalents 31st Dec., 1993		8,600
(Cash Rs 600 + Bank Rs 8,000)		

NOTES

Illustration 7.7 The Balance Sheet of *XYZ* Limited are as follows:

BALANCE SHEET (*Figures in 1994 thousand Rs*)

Liabilities	*1994 Rs*	*1995 Rs*	*Assets*	*1994 Rs*	*1995 Rs*
Equity	800	900	Fixed assets	600	800
General Reserve	300	400	Additions	200	100
P.& L. A/c 200	300		800	900	
Provision for Taxation	300	400	Depreciation	300	350
Overdraft	300	464		500	550
Sundry Creditors	1,200	1,000	Investments	200	—
Proposed Dividend	80	90	Stock	1,400	1,230
			Debtors	1,080	1,774
	3,180	3,554		3,180	3,554

PROFIT AND LOSS ACCOUNT
for the year ending...

Particulars	*1994 Rs*	*1995 Rs*	*Particulars*	*1994 Rs*	*1995 Rs*
To Taxation	250	450	By Trading Profit	430	660
To Proposed Dividend	80	90	By Profit on sale of Investment	—	30
To Transfer to General Reserve	100	100	By Income Tax excess provided		
To Balance c/f	200	300	in the previous year	—	50
			By Balance from last year	200	200
	630	940		630	940

Additional Information

(1) For the year ending 31 December, 1995, purchases were Rs 60 lakhs and sales were Rs 70 lakhs.

(2) Trading profit for the year ended 31 December, 1995 was arrived at after charging depreciation Rs 50,000 and directors remuneration Rs 1,20,000.

Prepare the Cash Flow Statement.

Solution:

(*i*) **Traditional Approach**

CASH FLOW STATEMENT
for the year ending 31 December, 1995 (*Rs in thousands*)

Overdraft as on 1 January, 1995		(300)
Add: Sources:		
Increase in Share Capital	100	
Investments sold (200 + 30)	230	330
Total Sources:		30
Less: Applications:		
Fixed Assets purchased	100	
Dividend paid	80	
Tax paid	300	
Cash Outflow on account of operations (Note *ii*)	14	(494)
Bank Overdraft as on 31 December, 1994		464

Working Notes:

(*i*) ADJUSTED PROFIT AND LOSS ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Provision for Tax	450	By Balanced b/d	200
To Proposed Dividend	90	By Provision for Tax (excess)	50
To Depreciation	50	By profit on sale of Investments	30
To Transfer to General Reserves	100	By Funds from Operations (bal. fig.)	710
To Balance c/d	300		
	990		990

NOTES

(*ii*) CASH FROM OPERATIONS

Particulars		*Rs*
Funds from Operations		710
Add: Decrease in Stock		170
	880	
Less: Increase in Debtors	694	
Decrease in Creditors	200	894
Cash Flow on account of Operations		14

(*iii*) PROVISION FOR TAXATION

Particulars	*Rs*	*Particulars*	*Rs*
To P. & L. A/c (Excess Provision)	50	By Balanced b/d	300
To Bank	300	By P. & L. A/c	450
To Balance c/d	400		
	750		750

Cash outflow on account of Operation could have also been found out as follows:

			Rs
	Trading Profit		660
Add:	Depreciation		50
	Funds from Operations		710
Add:	Decrease in Stock		170
			880
Less:	Increase in Debtors	694	
	Decrease in Creditors	200	894
	Cash Outflow on account of operation		14

(*ii*) **Modern Approach as per AS 3 (Revised)**

CASH FLOW STATEMENT
for the year ending 31st Dec., 1995 (*Rs in '000*)

Cash Flows from Operations:		
Funds from Operations		710
Adjustments for:		
Decrease in Stock		170
Increase in Debtors		(694)
Decrease in Creditors		(200)
Tax paid		(300)
Net Cash used for Operating Activities		(314)
Cash flows from Investing Activities:		
Fixed Assets purchased	(100)	
Investment sold	230	
Net Cash from Investing Activities		130
Cash Flows from Financing Activities:		
Proceeds from Issuance of Share Capital	100	
Dividends	(80)	
Net Cash from Financing Activities		20
Net Increase (Decrease) in Cash and Cash Equivalents		(164)
Cash and Cash Equivalents as on 1st Jan., 1995		(300)
Cash and Cash Equivalents as on 31st Dec., 1995		(464)

Cash Flow and Funds Flow Statements

Illustration 7.8. The financial of M/s *A* and *B* on 1st Jan. and 31st Dec., 1994 was as follows:

Liabilities	*1 Jan. Rs*	*31 Dec. Rs*	*Assets*	*1 Jan. Rs*	*31 Dec. Rs*
Current Liabilities for Goods	36,000	40,000	Cash	4,000	3,600
Mrs. A's Loan	—	20,000	Debtors	35,000	38,000
Loan from Bank	30,000	25,000	Stock	25,000	22,000
Hire-purchase Vendor	—	20,000	Land	20,000	30,000
Capital	1,48,000	1,54,000	Building	50,000	55,000
			Machinery	80,000	86,000
			Delivery Van	—	25,000
	2,14,000	2,59,600		2,14,000	2,59,600

Check Your Progress

3. State the effect of the following transactions, considered individually, on funds (working capital concept) and funds (cash concept):
   (a) Purchase of goods for cash.
   (b) Purchase of building against a long-term loan payable.
   (c) Bonus paid in the form of fully paid shares.

The delivery van was purchased in December, 1994 on hire-purchase basis; a payment of Rs 5,000 was made immediately and the balance of the amount is to be paid in 20 monthly instalments of Rs 1,000 each together with interest @ 12 per cent p.a. During the year the partners withdrew Rs 26,000 for domestic expenditure. The provision for depreciation against machinery on 31 December, 1993 was Rs 27,000 and on 31 December, 1994 Rs 36,000. You are required to prepare the Cash Flow Statement. Show also the Funds Flow Statement.

Solution:

(*i*) **Traditional Approach**

M/s A & B

CASH FLOW STATEMENT

for the year ending 31 Dec., 1994

Particulars	Rs
Cash Balance on 1st Jan.	4,000
Sources:	
From Operations (see note 2)	45,600
Loan from Mrs. *A*	20,000
Total Sources	69,600
Applications:	
Payment of Bank Loan	5,000
Payment for Delivery Van	5,000
Machinery Acquired	15,000
Buildings Acquired	5,000
Land Acquired	10,000
Withdrawals by Partners	26,000
	66,000
Cash Balance on 31 December	3,600

FUNDS FLOW STATEMENT

for the year ending 31st December, 1994

Particulars	*Rs*	*Particulars*	*Rs*
Funds from Operations	41,000	Repayment of Bank Loan	5,000
Loan from Mrs. *A*	20,000	Payment for Delivery Van	5,000
Decrease in Working Capital	17,000	Payable in a year for Delivery Van	12,000
		Machinery acquired	15,000
		Land acquired	10,000
		Buildings acquired	5,000
		Partners' drawings	26,000
	78,000		78,000

Working Notes

1. **Funds from Operations**

		Rs
	Capital as on 31 December, 1994	1,54,000
Add:	Drawings during the year	26,000
		1,80,000
Less:	Capital as on 1 January, 1994	1,48,000
	Profit for the year	32,000
Add:	Depreciation for the year (Rs 36,000 – Rs 27,000)	9,000
		41,000

2. **Cash from Operations**

	Funds From Operations		41,000
Add:	Decrease in Stock	3,000	
	Increase in Creditors	4,600	7,600
Less:	Increase in Debtors		48,600
	Cash from Operations		3,000
			45,600

NOTES

Check Your Progress

4. Cash flow statements is based upon:
   (a) Accrual basis of accounting
   (b) Cash basis of accounting

NOTES

3. MACHINERY ACCOUNT

Particulars	Rs	Particulars	Rs
To Balance b/d	80,000	By Depreciation for the year	9,000
To Bank (acquired during the year)	15,000	By Balance c/d	86,000
	95,000		95,000

(*ii*) **Modern Approach as per AS 3 (Revised)**

CASH FLOW STATEMENT

for the year ending 31st Dec., 1994

Particulars		Rs
Cash Flows from Operating Activities:		
Net Cash Flow from Operations		45,600
Cash Flow from Investing Activities:		
Purchase of Machinery	(15,000)	
Purchase of Building	(5,000)	
Purchase of Land	(10,000)	
Payment of Delivery Van	(5,000)	
Net Cash used in Investing Activities		(35,000)
Cash Flows from Financing Activities:		
Loan from Mrs. *A*	20,000	
Payment of Bank Loan	(5,000)	
Drawings by Partners	(26,000)	
Net Cash used in Financing Activities		(11,000)
Net Increase (Decrease) in Cash and Cash Equivalents		(400)
Cash and Cash Equivalents as on 1st Jan., 1994		4,000
Cash and Cash Equivalents as on 31st Dec., 1994		3,600

7.9 MEANING OF FUNDS FLOW STATEMENT

It will be appropriate to explain the meaning of the term ‘Funds’ and the term ‘Flow of Funds’ before explaining the meaning of the term ‘Funds Flow Statement’.

7.9.1 Meaning of Funds

The term ‘Funds’ has a variety of meanings. There are people who take it to be synonymous with cash and to them there is no difference between a Funds Flow Statement and a Cash Flow Statement. Others include marketable securities besides cash in the definition of the term ‘Funds’. The International Accounting Standard No. 7 on ‘Statement of Changes in Financial Position’ also recognises the absence of a single, generally accepted, definition of the term. According to the standard, ‘the term “fund” generally refers to cash and cash equivalents, or to working capital.’ Of these, the last definition of the term is by far the most common definition of ‘fund’.

There are also two concepts of working capital—*gross concept and net concept. Gross working capital* refers to the firm’s investment in current assets while the term *net working capital* means excess of current assets over current liabilities.[1] It is in the latter sense in which the term ‘funds’ is generally used.

The meanings of two terms ‘current assets’ and ‘current liabilities’ have already been explained in a preceding chapter. However, for the sake of ready reference, we are giving below the meanings of these two terms ‘current assets’ and ‘current liabilities’ besides explaining ‘non-current assets’ and ‘non-current liabilities.’

———————

[1] Institute of Chartered Accountants India (*ICAI*): ‘Working Capital means the funds available for conducting day to day operations of an enterprise. Also represented by excess of current assets over current liabilities including short-term loans’.

Current assets The term 'Current Assets' includes assets which are acquired with the intention of converting them into cash during the normal business operations of the company. However, the best definition of the term 'Current Assets' has been given by Grady in the following words:

'For accounting purposes, the term "Current Assets" is used to designate cash and other assets or resources commonly identified as those which are reasonably expected to be realised in cash or sold or consumed during the normal operating cycle of the business.'[2]

The broad categories of current assets, therefore, are (*i*) Cash including fixed deposits with banks, (*ii*) Accounts receivable, i.e., trade debtors and bills receivable, (*iii*) Inventory, i.e., stocks of raw materials, work-in-progress, finished goods, stores and spare parts, (*iv*) Advances recoverable, i.e., the advances given to supplier of goods and services or deposits with government or other public authorities e.g., customs, port authorities, advance income tax, etc., (*v*) Pre-paid expenses, i.e., cost of unexpired services, e.g., insurance premiums paid in advance, etc.

It should be noted that short-term investments should be included in the definition of the term current assets, while loose tools should be excluded from the category of current assets. Of course, this is not strictly according to the requirements of the Companies Act regarding presentation of financial statements where investments, even though held temporarily, are to be shown separately from current assets while loose tools are to be shown under the category of current assets.

Current liabilities The term 'Current Liabilities' is used principally to designate such obligations whose liquidation is reasonably expected to require the use of assets classified as current assets in the same balance sheet or the creation of other current liabilities, or those expected to be satisfied within a relatively short period of time usually one year.[1] However, this concept of current liabilities has now undergone a change. The more modern version designates current liabilities as all obligations that will require within the coming year or the operating cycle, whichever, is longer, (*i*) the use of existing current assets or (*ii*) the creation of other current liabilities.[2] In other words, the mere fact that an amount is due within a year does not make it a current liability unless it is payable out of existing current assets or by creation of current liabilities. For example, debentures due for redemption within a year of the balance sheet date will not be taken as a current liability if they are to be paid out of the proceeds of a fresh issue of shares/ debentures or out of the proceeds realised on account of sale of debentures redemption fund investments.

The term current-liabilities also includes amounts set apart or provided for any known liability of which the amount cannot be determined with substantial accuracy, e.g., provision for taxation, pension etc., These liabilities are technically called provisions rather than liabilities.

The broad categories of current liabilities are:

(*i*) Accounts payable e.g., bills payable and trade creditors.

(*ii*) Outstanding expenses, i.e., expenses for which services have been received by the business but for which the payment has not been made.

(*iii*) Bank overdrafts.

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[2] Paul Grady: 'Inventory of Generally Accepted Accounting Principles for Business Enterprises.' pp. 234–235. *Accounting Research Study*, No. 7. American Institute of Certified Public Accountants.

NOTES

(*iv*) Short-term loans, i.e., loans from banks etc., which are payable within one year from the date of Balance Sheet.

(*v*) Advance payments received by the business for the services to be rendered or goods to be supplied in future.

(*vi*) Current maturities of long-term loans, i.e., long-term debts due within a year of the balance sheet date or instalments due within a year in respect of these loans, provided payable out of existing current assets or by creation of current liabilities, as discussed earlier. However, instalments of long-term loans due after a year should be taken as non-current liabilities.

Provisions against Current Assets. Provisions against current assets, such as provision for doubtful debts, provisions for loss of stock, provision for discount on debtors, etc., are treated as current liabilities, since they reduce the amount of current assets.

Non-current assets All assets other than current assets come within the category of non-current assets. Such assets include goodwill, land, building, machinery, furniture, long-term investments, patent rights, trade marks, debit balance of the Profit and Loss Account, discount on issue of shares and debentures, preliminary expenses, etc.

Non-current liabilities All liabilities other than current liabilities come within the category of non-current liabilities. They include share capital, long-term loans, debentures, share premium, credit balance in the Profit and Loss Account, revenue and capital reserves (e.g., general reserve, dividend equalisation fund, debentures sinking fund, capital redemption reserve) etc.

7.9.2 Meaning of 'Flow of Funds'

The term 'Flow' means change and, therefore, the term 'Flow of Funds' means 'Change in Funds' or 'Change in Working Capital'. In other words, any increase or decrease in working capital means 'Flow of Funds'.

In business, several transactions take place. Some of these transactions increase the funds while others decrease the funds. Some may not make any change in the funds position. In case a transaction results in increase of funds, it will be termed as a 'source of funds.' For, example, if the funds are Rs 10,000 and on account of a business transaction, say, issue of shares, they become Rs 15,000, 'Issue of Shares' will be taken as a source of funds. In case a transaction results in decrease of funds it will be taken as an application or use of funds. For example, if the funds are Rs 10,000 and on account of a transaction say, purchase of furniture of Rs 5,000, they stand reduced to Rs 5,000, the purchase of furniture will be taken as an 'application of funds.' In case a transaction does not make any change in the funds position that existed just before the happening of the transaction, it is said that it is a non-fund transaction, For example, if the funds are Rs 10,000 and a fixed asset of Rs 5,000 is purchased by issuing shares of Rs 5,000 the funds position will not change, and therefore, this transaction will be taken as a non-fund transaction.

The following extracts from the Balance Sheet of a Company will give a more detailed and clear concept of the term 'Flow of Funds':

NOTES

	Rs		*Rs*
Non-current Liabilities:		Non-current Assets:	
Share capital		Goodwill	50,000
12 per cent redeemable preference		Buildings	1,00,000
share of Rs 10 each	1,00,000	Plant	1,00,000
Equity shares of Rs 10 each	1,00,000	Furniture	50,000
Long-term Loans:		Long-term investments	50,000
10 per cent Debentures	1,00,000		
Loan on mortgage	50,000		
Reserves and surplus:			
General reserve	1,00,000		
Profit and loss A/c	50,000		
Total Non-current Liabilities (*i*)	5,00,000	Total Non-current Assets (*iii*)	3,50,000
Current Liabilities:	*Rs*	Current Assets:	*Rs*
Sundry creditors	50,000	Sundry debtors	80,000
Bills payable	50,000	Bills receivable	50,000
Bank overdraft	25,000	Inventories	1,00,000
Outstanding expenses	25,000	Pre-paid expenses	50,000
		Cash balance	20,000
Total Current Liabilities (*ii*)	1,50,000	Total Current Assets (*iv*)	3,00,000
Total Liabilities (*i*) + (*ii*)	6,50,000	Total Assets (*iii*) + (*iv*)	6,50,000

The above extracts from the Balance Sheet show that the Company has got a working capital of Rs 1,50,000 computed as given below:

Current assets	Rs 3,00,000
Current liabilities	1,50,000
Working capital	1,50,000

There will be a flow of funds in case the working capital position of the company changes on account of any transaction. We are giving some of the transactions which have taken place after preparation of the above Balance Sheet of the company. Each transaction has been considered independently:

1. The company realises Rs 20,000 from its debtors. This transaction will reduce the debtors from Rs 80,000 to Rs 60,000 but increase the cash balance from Rs 20,000 to Rs 40,000. Thus, the total current assets continue at the old figure of Rs 3,00,000. This means this transaction will not bring any change in the working capital position of the company. It is simply conversion of one current asset into another current asset.
2. The company pays to its creditors a sum of Rs 10,000 out of the cash balance. This will reduce the cash balance from Rs 20,000 to Rs 10,000. The total current assets will stand reduced from Rs 3,00,000 to Rs 2,90,000. The sundry creditors will stand reduced from Rs 50,000 to Rs 40,000. Thus, the position will be as follows:

Current assets	Rs 2,90,000
Current liabilities	1,40,000
Working capital	1,50,000

Thus, the transaction has not resulted in any change in the working capital position. It continues to stand at Rs 1,50,000. This is because the two accounts involved in the transaction are the constitutions of working capital itself, i.e., current assets and current liabilities.

3. The company purchase furniture of Rs 10,000 by raising long-term loan of Rs 10,000. This transaction will not have any effect on working capital position, since the transaction involves a non-current asset and a non-current liability which are not the constituents of the working capital.

NOTES

4. The company redeems preference shares of Rs 1,00,000 by issuing 12 per cent debentures of Rs 1,00,000. This transaction will also not involve any change in the working capital position on account of the fact that both the two accounts involved in the transactions are not the constituents of the working capital.
5. The company raises Rs 50,000 in cash by issue of new shares. This transaction will increase the cash balance of the company from Rs 20,000 to Rs 70,000 while there will be no change in the current liabilities position. The working capital will, therefore, be computed as follows:

Current assets	Rs	3,50,000
Current liabilities		1,50,000
Working capital		2,00,000

The transaction has resulted in increase of working capital.

6. The company sells its building having a book value of Rs 50,000 for a sum of Rs 60,000. This transaction will increase the cash balance with the company from Rs 20,000 to Rs 80,000. The total current assets will amount to Rs 3,60,000 while the total current liabilities continue to stand at Rs 1,50,000. The working capital will, therefore, be a sum of Rs 2,10,000.

The transaction has brought a change in the working capital position because one account (i.e., building) is a non-current asset account while the other account (i.e., cash) is a current assets account.

From the above, the following general rules can be formed:

1. There will be 'flow of funds' if a transaction involves:
   (*i*) current assets and fixed assets, e.g., purchase of building for cash;
   (*ii*) current assets and capital, e.g., issue of shares for cash;
   (*iii*) current assets and fixed liabilities, e.g., redemption of debentures in cash;
   (*iv*) current liabilities and fixed liabilities, e.g., creditors paid off in debentures;
   (*v*) current liabilities and capital e.g., creditors paid off in shares;
   (*vi*) current liabilities and fixed assets e.g., buildings transferred to creditors in satisfaction of their claims.
2. There will be 'no flow of funds' if a transaction involves.
   (*i*) current assets and current liabilities. e.g., payment made to creditors in cash;
   (*ii*) fixed assets and fixed liabilities, e.g., building purchased and payment made in debentures;
   (*iii*) fixed assets and capital e.g., building purchased and payment made in shares.

7.9.3 Finding out of Transaction Involving Change in Working Capital

In order to determine whether a transaction will result in change of working capital or not, it will be appropriate to pass a journal entry for the transaction. In case the entry involves accounts which are only of a fixed (asset or liability) nature or only of a current (asset or liability) nature, there will be no flow of funds. But a 'cross transaction' (i.e. a transaction involving a fixed asset or a fixed liability and a current asset or a current liability) will result in flow of funds. We are giving below an analysis of certain transactions to make this point clear.

Check Your Progress

5. Fill in the blanks.
(a) Funds flow refers to changes in ...... capital.
(b) Building sold on credit is ...... of funds.
(c) Goods purchased on credit ...... in flow of funds.
(d) Commission outstanding is ...... of funds.
(e) Any gain on sale of non-current assets should be ...... from the net profit for determining funds from operations.
(f) Difference between Current Assets and Current Liabilities is known as ....
(g) Depreciation is sometimes treated as ...... funds.

NOTES

1. When shares are issued for cash, the journal entry is:

   Bank A/c Dr.
   To Share Capital A/c

   Bank account is a current asset while share capital account is a fixed liability. Thus, this is a cross-transaction. It will, therefore, result in change in working capital.

2. When shares are issued to the vendors for purchase of building, the effective journal entry is:

   Building A/c Dr.
   To Share Capital A/c

   Building is a fixed asset while share capital is a fixed liability. There is no 'cross-transaction' and, therefore, there will be no change in the funds position of the business.

3. When debtors are realised.

   Bank A/c Dr.
   To Sundry Debtors

   Bank and Debtors both are current assets and, therefore, there will be no change in the funds position of the business.

4. When a provision for doubtful debts is made:

   Profit and Loss A/c Dr.
   To Provision for Doubtful Debts

   Profit and Loss Account is a fixed liability since it is part of the shareholders' funds while provision for doubtful debts is a current liability (it reduces debtors), There is a 'cross' transaction and, therefore, there will be flow of funds. The funds will decrease.

5. When creditors are issued bills payable:

   Creditors A/c Dr.
   To Bills Payable

   Both creditors and bills payable are current liabilities and, therefore, there will be no effect on funds.

6. When payment of bills payable is made:

   Bills Payable A/c Dr.
   To Bank

   Bills payable and Bank both belong to the category of 'current' accounts and, therefore, there will be no effect on funds.

7. Cash realised from bills receivable:

   Bank A/c Dr.
   To Bills Receivable

   There will be no flow of funds since both are 'current' accounts.

8. Loss on sale of machinery:

   Profit and Loss A/c Dr.
   To Machinery A/c

   Since both are 'non-current' accounts, therefore, there will be no flow of funds.

9. Money realised on account of sale of machinery:

   Bank A/c Dr.
   To Machinery A/c

   Bank Account is a current asset account, while Machinery Account is a fixed asset account. Hence, there is a 'cross' transaction. The funds will, therefore, increase on account of this transaction.

NOTES

10. Transfer to General Reserve:

Profit and Loss Appropriation A/c	Dr.
To General Reserve	

Both are 'non-current' accounts and, therefore, there will be no flow of funds.

11. Building sold on credit:

Debtors A/c	Dr.
To Building A/c	

Debtors Account is a current asset account, while building account is a fixed asset account. Thus, there is a 'cross' transaction and, therefore, there will be flow of funds. The funds would increase by the sale value of the building.

12. Inventory purchased by issuing shares:

Inventories A/c	Dr.
To Share Capital	

Inventories belong to the category of current assets while share capital belongs to the category of non-current liabilities. There is a 'cross' transaction and, therefore, there will be flow of funds. The funds would increase by the amount.

13. Rent paid:

Rent A/c	Dr.
To Bank	

Rent Account will be transferred to the Profit and Loss Account at the end of the accounting period. The entry will be:

Profit and Loss A/c	Dr.
To Rent	

Thus, the effective entry has been

Profit and loss A/c	Dr.
To Bank	

Profit and Loss Account is a non-current liability, while Bank Account is a current asset. There is a 'cross' transaction and hence, there will be flow of funds.

A funds flow statement is, therefore, a statement depicting change in working capital. It is also termed as a 'Statement of Sources and Application of Funds', 'Summary of Financial Operations', 'Funds Generated and Expended', 'Where got and Where gone Statement', 'Statement of Changes in Working Capital', etc.

7.10 USES OF FUNDS FLOW STATEMENT

The funds flow statement helps the financial analyst to get a more detailed analysis and understanding of changes in the distribution of resources between two balance sheet dates. In case such a study is required regarding the future working capital position of the company, a projected funds flow statement can be prepared. The uses of a funds flow statement are as follows:

It explains the financial consequences of business operations The funds flow statement provides a ready answer to so many conflicting situations, such as:

(*a*) Why is the liquid position of the business becoming more and more unbalanced in spite of business making more and more profits?

(*b*) How was it possible to distribute dividends in excess of current earnings or in the presence of a net loss for the period?

(*c*) How does the business could have good liquid position in spite of business making losses or acquisition of fixed assets?

(*d*) Where have the profits gone?

NOTES

Definite answers to these question will help the financial analyst in advising his employer/client regarding directing of funds to those channels which will be most profitable for the business.

It answers intricate queries The financial analyst can find answers to a number of intricate questions:

(*a*) What is the overall creditworthiness of the enterprise?

(*b*) What are the sources of repayments of the loans taken?

(*c*) How much are the funds generated through normal business operations?

(*d*) In what way has the management utilised the funds in the past and what are going to be the likely uses of funds?

It acts as an instrument for allocation of resources A projected funds flow statement will help the analyst in finding out how the management is going to allocate the scarce resources for meeting the productive requirements of the business. The use of funds should be phased in such an order that the available resources are put to the best use of the enterprise. The funds should be managed in such a way that the business is in a position to make payment of interest and loan instalments as per the agreed schedule.

It is a test as to effective or otherwise use of working capital The funds flow statement is a test of the effective use of working capital by the management during a particular period. The adequacy or inadequacy of working capital will tell the financial analyst about the possible steps that the management should take for effective use of surplus working capital or make arrangements in case of inadequacy of working capital.

7.11 FUNDS FLOW STATEMENT AND INCOME STATEMENT

A Funds Flow Statement differs from an Income Statement (i.e., Profit and Loss Account) in several respects:

(*i*) A Funds Flow Statement deals with the financial resources required for running the business activities. It explains how the funds were obtained and how were they used. Whereas an Income Statement discloses the results of the business activities, i.e., how much has been earned and how it has been spent.

(*ii*) A Funds Flow Statement matches the 'funds raised' and 'funds applied' during a particular period. The sources and applications of funds may be of capital as well as of revenue nature. An Income Statement matches the incomes of a period with the expenditure of that period which are both of a revenue nature. For example, where shares are issued for cash, it becomes a source of funds while preparing a funds flow statement but it is not an item of income for an Income Statement.

(*iii*) Sources of funds are many besides operations such as share capital, debentures, sale of fixed assets, etc. An Income Statement which discloses the results of operations cannot even accurately show the funds from operations alone because of non-fund items (such as depreciation, writing off of fictitious assets etc.) being included therein.

Thus, both the Income Statement and the Funds Flow Statement have different functions to perform. Modern management needs both. One cannot be a substitute for the other—rather they are complementary to each other.

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7.12 PREPARATION OF FUNDS FLOW STATEMENT

In order to prepare a Funds Flow Statement, it is necessary to find out the 'sources' and 'applications' of funds.

7.12.1 Sources of Funds

The source of funds can be both internal as well as external.

Internal sources Funds from operations is the only internal source of funds. However, following adjustments will be required in the figure of Net Profit for finding out real funds from operations:

Add the following items as they do not result in outflow of funds:

(*i*) Depreciation on fixed assets.

(*ii*) Preliminary expenses or goodwill, etc., written off.

(*iii*) Contribution to debenture redemption funds, transfer to general reserve, etc., if they have been deducted before arriving at the figure of net profit.

(*iv*) Provision for taxation or proposed dividend are usually taken as appropriation of profits only and not current liabilities for the purposes of Funds Flow Statement. This is discussed in detail later. Tax or dividends actually paid are taken as applications of funds. Similarly interim dividend paid is shown as an application of funds. All these items will be added back to net profit, if already deducted, to find funds from operations.

(*v*) Loss on sale of fixed assets.

Deduct the following items as they do not increase funds:

(*i*) Profit on sale of fixed assets since the full sale proceeds are taken as a separate source of funds and inclusion here will result in duplication.

(*ii*) Profit on revaluation of fixed assets.

(*iii*) Non-operating incomes such as dividend received or accrued dividend, refund of income-tax, rent received or accured rent. These items increase funds but they are non-operating incomes. They will be shown under separate heads as 'source of funds' in the Funds Flow Statement.

In case the Profit and Loss Account shows 'Net Loss', this should be taken as an item which decreases the funds.

Illustration 7.9 From the following Profit and Loss Account, compute the funds from operations:

PROFIT AND LOSS ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Salaries	5,000	By Gross Profit b/d	1,000
To Rent	2,000	By Rent	5,000
To Depreciation	1,000	By Interest on Investments	4,000
To Preliminary Expenses	2,000	By Net Loss	5,000
To Loss on sale of land	5,000		
	15,000		15,000

NOTES

Solution:

FUNDS FROM OPERATIONS

	Net Loss as per Profit and loss A/c		
Rs (–) 5,000			
Add:	Items which do not decrease funds:		
	Depreciation	Rs 1,000	
	Preliminary expenses	2,000	
	Loss on sale of land	5,000	8,000
	Funds from operations		3,000

It may be noted that the two items 'Rent' and 'Interest on Investments' are strictly not items of operating incomes. In case it is desired to calculate 'funds from operations' in a *strict sense*, any non-operating income will have also to be excluded while finding out funds from operations. Such items will be shown as a separate source under the head, 'Non-operating income' in the Funds Flow Statement. In the present illustration the items will then appear in the Funds Flow Statement as follows:

FUNDS FLOW STATEMENT

Sources:	*Rs*
Funds from Non-operating Incomes	9,000
Applications:	
Outflow of Funds on account of operations (Rs 3,000 – Rs 9,000)	6,000
increase in Working Capital	3,000

Tutorial Note:

The students should not interpret the term 'funds from operations' so strictly. They may solve an examination problem as per solution given in the first alternative.

Illustration 7.10 The net profit after making a provision of Rs 3,30,000 for Income Tax of Tata Ltd. for the year ended 31st March, 1997 amounts to Rs 3,00,000. This figure of the net profit has been arrived at after taking into account the following items:

	Rs
Depreciation on fixed assets	65,000
Preliminary expenses written off	7,000
Bad debts	1,000
Loss on sale of furniture	1,500
Profit on sale of long-term investments	5,000

Calculate Funds from Operations

Solution:

FUNDS FROM OPERATIONS

Profit after Tax			Rs 3,00,000
Add:	Depreciation on Fixed Assets	65,000	
	Preliminary expenses written off	7,000	
	Loss on sale of furniture	1,500	73,500
			3,73,500
Less:	Profit on sale of Long-term Investments		5,000
	Funds from Operations		3,68,500

Illustration 7.11 Following are the extracts from the Balance Sheet of a company as on 31 December, 1996 and 31 December, 1997. You are required to calculate funds from operations:

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	As on 31 December 1996	1997
Profit and Loss Appropriation Account	30,000	40,000
General Reserve	20,000	25,000
Goodwill	10,000	5,000
Preliminary Expenses	6,000	4,000
Provisions for Depreciation on Machinery	10,000	12,000

Solution:

FUNDS FROM OPERATIONS

		Rs
	Profit and Loss Appropriation A/c balance as on 31 December, 1997	40,000
Add:	Items which do not decrease funds:	
	Transfer to General Reserve	5,000
	Goodwill written off	5,000
	Preliminary Expenses written off	2,000
	Provision for Depreciation on Machinery	2,000
		54,000
Less:	Profit and Loss Appropriation A/c balance as on 31 December, 1996	30,000
	Funds from Operations	24,000

The funds from operations can also be found out by preparing an Adjusted Profit and Loss Account:

ADJUSTED PROFIT AND LOSS ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Transfer to General Reserve	5,000	By Balance b/d	30,000
To Goodwill written off	5,000	By Funds from Operations (bal. fig.)	24,000
To Preliminary Expenses written of	2,000		
To Provision for Depreciation	2,000		
To Balance c/d	40,000		
	54,000		54,000

External Sources These sources include:

Funds from long-term loans Long-term loans such as debentures, borrowings from financial institutions will increase the working capital and, therefore, there will be flow of funds. However, if the debentures have been issued in consideration of some fixed assets, there will be no flow of funds.

Sale of fixed assets Sale of land, buildings, long-term investments will result in generation of funds.

Funds from increase in share capital Issue of shares for cash or for any other current asset results result in increase in working capital and hence there will be flow of funds.

7.12.2 Applications of Funds

The uses to which funds are put are called 'applications of funds'. Following are some of the purposes for which funds may be used:

Purchase of fixed assets Purchase of fixed assets such as land, building, plant, machinery, long-term investments, etc., results in decrease of current assets without any decrease in current liabilities. Hence, there will be a flow of funds. But in case shares or debentures are issued for acquisition of fixed assets, there will be no flow of funds.

Payment of dividend Payment of dividend results in decrease of a fixed liability and, therefore, it affects funds. Generally, recommendation of directors regarding declaration of dividends (i.e. proposed dividends) is simply taken as an appropriation of profits and not as an item affecting the working capital. This has been explained in detail later.

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Payment of fixed liabilities Payment of a long-term liability, such as redemption of debentures or redemption of redeemable preference shares, results in reduction of working capital and hence it is taken as an application of funds.

Payment of tax liability Provision for taxation is generally taken as an appropriation of profits and not as an application of funds. But if the tax has been paid, it will be taken as an application of funds. This has been explained in detail later.

7.12.3 Technique for Preparing a Funds Flow Statement

A funds flow statement depicts change in working capital. It will, therefore, be better for the students to prepare first a Schedule of Changes in Working Capital before preparing a Funds Flow Statement.

Schedule of changes in working capital The schedule of changes in working capital can be prepared by comparing the current assets and the current liabilities of two periods. It may be in the following form:

Items	*as on*	*as on*	*Change*	
	...	...	*Increase*	*Decrease*
Current Assets:				
Cash balance				
Bank balance				
Marketable securities				
Accounts receivable				
Stock-in trade				
Prepaid expenses				
Current Liabilities:				
Bank overdraft				
Outstanding expenses				
Accounts payable				
Net Increase/Decrease in Working Capital:				

Rules of preparing the schedule

(*i*) Increase in a current asset, results in increase (+) in 'working capital.'
(*ii*) Decrease in a current asset, results in decrease (–) in 'working capital.'
(*iii*) Increase in a current liability, result in decrease (–) in 'working capital.'
(*iv*) Decrease in a current liability, results increase (+) in 'working capital.'

Funds flow statement While preparing a Funds Flow Statement, current assets and current liabilities are to be ignored. Attention is to be given to changes in Fixed Assets and Fixed Liabilities. The statement may be prepared in the following form:

FUNDS FLOW STATEMENT

Sources of Funds:		
Issue of shares		.....
Issue of debentures		.....
Long-term borrowings		.....
Sale of fixed assets		.....
Operating profit*		.....
	Total Sources	.....
Applications of funds:		.....
Redemption of redeemable preference shares		.....
Redemption of debentures		.....
Payment of other long-term loans		.....
Purchase of fixed assets		.....
Operating loss*		.....
Payment of dividends, tax, etc.		.....
	Total Uses	.....
Net increase/decrease in working capital (Total Sources–Total Uses)		.....

* Only one figure will be there.

NOTES

The Funds Flow Statement can also be prepared in '*T*' shape form as shown below:

FUNDS FLOW STATEMENT

Particulars	*Rs*	*Particulars*	*Rs*
Sources of Funds:		Applications of Funds:	
Issue of shares	.....	Redemption of redeemable preference shares	....
Issue of debentures	.....	Redemption of debentures	....
Long-term borrowings	.....	Payment of other long-term loans	.....
Sale of fixed assets	.....	Purchase of fixed assets	.....
Operating profit*	.....	Operating loss*	.....
Decrease in working capital*	.....	Payment of dividends, tax etc.	.....
		Increase in working capital*	.....
	......		.....

* Only one figure will be there.

The change in working capital disclosed by the 'schedule of changes in working capital' will tally with the change disclosed by 'funds flow statement'.

Proforma of adjusted profit and loss account

	Particulars	*Rs.*		*Particulars*	*Rs.*
To	Depreciation and Depletion or amortization of fictitious and intangible assets, such as: Good-will, Patents, Trade Marks, Preliminary Expenses, etc.	xxx	By	Opening Balance (of P&L A/c)	xxx
To	Appropriation of Retained Earnings, such as: Transfers to General Reserve, Dividend Equalisation Fund, Sinking Fund, etc.	xxx	By	Transfers from excess provisions	xxx
To	Loss on sale of any non-current or fixed asset	xxx	By	Appreciation in the value or non-current assets	xxx
To	Dividends (including interim dividend)	xxx	By	Dividends received	xxx
To	Proposed Dividend (if not taken as a current liability)	xxx	By	Profit on sale of fixed or non-current assets	xxx
To	Closing balance of P&L A/c	xxx	By	Funds from operations (balancing figure in case debit side exceeds credit side)	xxx
To	Funds lost in Operations (balancing figure, in case credit side exceeds the debit-side)	xxx			xxx
					xxx
		xxx			xxx

Notes:

- *Depreciation on fixed assets or amortisation of intangible assets like preliminary expenses, patents, goodwill, etc., written off is charged against profit to reflect the use of fixed assets or written off of intangible asset. In these transactions no corresponding cash outlay occurs and hence, add back the amount charged against profit, to arrive at the total funds generated from business operations.*
- *The Profit or Loss on sale of non-current assets (fixed assets and long-term investments) is adjusted to arrive at the true funds from operations.*
- *The provision for tax made in the profit and loss account is to be added back to the reported profit. The actual amount paid as tax is to be shown as the application of funds in the funds flow statement. The provision for tax, if it is shown in the*

balance sheet, need not be considered for calculation of funds generated for operations.

- *Any amount appropriated in the Profit and Loss account towards transfer to reserves or proposed dividend is to be added back to arrive at the funds generated from operation. The actual amount paid as dividend is to be shown as application of funds in the funds flow statement. The dividend proposed but awaiting payment is a current liability in the balance sheet. If this amount increases, from one year end to the next, the extra liability appears as a source of funds.*

NOTES

7.13 TREATMENT OF PROVISION FOR TAXATION AND PROPOSED DIVIDENDS

7.13.1 Provision of Taxation

In the chapter on 'Financial Statement: Analysis and Interpretation' we have studied that the 'provision for tax' is a current liability. While preparing a Funds Flow Statement, there are two options available[1]:

(*i*) Provision for tax may be taken as a current liability. In such a case, when provision for tax is made the transaction involves Profit and Loss Appropriation Account, which is a fixed liability and Provision for Tax Account, which is a current liability. It will thus decrease the working capital. On payment of tax there will be no change in working capital because it will involve one current liability (i.e., Provision for Tax and the other current asset (i.e. Bank or Cash balance).

(*ii*) Provision for tax may be taken only as an appropriation of profit. It means there will be no change in working capital position when provision for tax is made since it will involve two fixed liabilities i.e. Profit and Loss Appropriation Account and Provision for Tax Account. However, when tax is paid, it will be taken as application of funds, because it will then involve 'provision for tax account' which has been taken as a fixed liability and 'bank account' which is a current asset.

7.13.2 Proposed Dividends

Whatever has been said about the 'provision for taxation' is also applicable to 'proposed dividends.' Proposed dividends can also be dealt with in two ways:

(*i*) Proposed dividends may be taken as a current liability since declaration of dividends by the shareholder is simply a formality. Once the dividends are declared at the general meeting, they will have to be paid within 42 days of their declaration. In case the proposed dividend is taken as a current liability, it will appear as one of the items decreasing working capital in the 'schedule of changes in working capital'. It will not be shown as an application of funds when dividend is paid later on.

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[1] It may be noted that AS: 3 'Statement of Changes in Financial Position', (now replaced by Cash Flow Statements) issued by the Institute of Chartered Accountants of India, allowed both the options given above. It gave two formats in the Appendix attached to AS: 3. In one format it showed 'Payment of Dividends' in the Funds Flow Statement as an application, while Provision for Tax as a current liability in the Schedule for Changes in Working Capital. It meant that the proposed dividends was taken as a non-current liability while Provision for Tax was taken as a current liability. In the second format it showed both Dividends and Tax paid as 'applications of funds.' In other words Proposed Dividends and Provision for Taxation were taken non-current liabilities. Moreover, it was also stated that methods of presentation used are illustrative only and in no way prescriptive. Other methods of presentation may equally comply with the accounting standard. The format used should be selected with a view to demonstrate clearly the manner in which the financial resources have been obtained and utilised.

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(*ii*) Proposed dividends may simply be taken as an appropriation of profits. In such a case proposed dividend for the current year will be added back to the current year's profits in order to find out funds from operations if such amount of dividend has already been charged to profits. Payment of dividend will be shown as an 'application of funds.'

Illustration 7.12 Form the following Balance Sheets as on 31 December, 1996 and 31 December, 1997, you are required to prepare a Schedule of Changes in the Working Capital and a Funds flow Statement taking:

(*i*) the provision for tax and proposed dividends as non-current liabilities;

(*ii*) the provision for tax and proposed dividends as current liabilities.

BALANCE SHEET
as on 31 December

Liabilities	*1996 Rs*	*1997 Rs*	*Assets*	*1997 Rs*	*1998 Rs*
Share Capital	10,000	15,000	Fixed Assets	10,000	20,000
Profit and Loss A/c	4,000	6,000	Current Assets	13,000	14,500
Provision for Tax	2,000	3,000			
Proposed Dividends	1,000	1,500			
Sundry Creditors	4,000	6,000			
Outstanding Expenses	2,000	3,000			
	23,000	34,500		23,000	34,500

Additional Information

Tax paid during 1997	Rs 2,500
Dividends paid during 1997	Rs 1,000

Solution:

(*i*) *When Provision for Tax and Proposed dividends are taken as non-current liabilities:*

SCHEDULE OF CHANGES IN WORKING CAPITAL

Particulars	*Increase (+) Rs*	*Decrease (–) Rs*
Sundry Creditors	—	2,000
Outstanding Expenses	—	1,000
Current Assets	1,500	
Decrease in Working Capital	1,500	
	3,000	3,000

FUNDS FLOW STATEMENT

Source:		
Increase in Share Capital		Rs 5,000
Funds from Operations:		
Net Profit	Rs 2,000	
Add: Provision for Tax made during the year (Rs 3,000 + Rs 2,500 – Rs 2,000)	3,500	
Add: Proposed Dividends	1,500	7,000
Total Sources		12,000
Applications:		
Fixed assets purchased		10,000
Tax paid		2,500
Dividends paid		1,000
Total Applications		13,500
Net Decrease in Working Capital		1,500

(*ii*) *When Provision for Tax and Proposed Dividends are taken as Current Liabilities:*

SCHEDULE OF CHANGES IN WORKING CAPITAL

Particulars	*Increase (+) Rs*	*Decrease (–) Rs*
Sundry Creditors		2,000
Outstanding Expenses		1,000
Current Assets	1,500	
Provision for Tax		1,000
Proposed Dividends		500
Decrease in Working Capital	3,000	
	4,500	4,500

FUNDS FLOW STATEMENT

Particulars	*Rs*
Sources:	
Increase in Share Capital	5,000
Funds from Operations	2,000
Total Sources	7,000
Applications:	
Purchase of Fixed Assets	10,000
Decrease in Working Capital	3,000

Alternative Solution to (*ii*). Sometimes it is desired to show the real funds from operations before tax and making any appropriations for dividends, etc. In such a case Proposed Dividends and Provision for Tax are first added back to profit if already subtracted and then any tax or dividend paid for the year or outstanding for the year is shown as an application.

The Funds Flow Statement, in the above illustration, will appear as follows if this alternate approach is followed.

FUNDS FLOW STATEMENT

Particulars	*Rs*	*Rs*
Source:		
Increase in Share Capital		5,000
Funds from Operations:		
Net Profit	2,000	
Add: Provision for tax made during the year	3,500	
Proposed dividends for the year	1,500	7,000
		(A) 12,000
Applications:		
Fixed assets purchased		10,000
Tax paid and outstanding for the year (500 + 3,000)*		3,500
Dividends paid and outstanding for the year (0 + 1,500)*		1,500
		(*B*) 15,000
Decrease in Working Capital (*A*) – (*B*)		3,000

*Provision for tax was Rs 2,000 last year. Tax paid amounts to Rs 2,500 this year. It means excess of Rs 500 relates to this year. A provision of Rs 3,500 has been made during the year. Thus, Rs 3,000 is still outstanding. Tax paid and outstanding for the year therefore amounts to Rs 3,500. In other words, whatever was added to the amount of Net profits for ascertaining 'real funds from operations' has been shown as an application. The net effect is zero. The same applies to Proposed Dividends.

It has become customary to take Provisions for Tax as a charge against profits for accounting purposes Hence, funds from operations should be found out after tax. However, where Proposed Dividend is taken as a current liability, the above approach in respect of it may be adopted.

NOTES

Tutorial Note:

Students are advised to state their presumptions clearly. However, where from the question it is implied that these liabilities are to be taken as Current Liabilities (e.g. the items have been put under the heading 'Current Liabilities' in the Balance Sheet), the students are advised to treat them as Current Liabilities. We have generally taken these two items as *non-current liabilities*.

In case the Balance Sheet contains the amount of 'Proposed Dividends' as well as the amount of 'Provision for Taxation', it can be presumed that the Proposed Dividends' and 'Provisions for Taxation' appearing in the last year's Balance Sheet must have been paid during the year in the absence of any other information. This presumption should generally be made at least for 'Proposed Dividends.'

Example. The following are extracts from the Balance Sheets of a company on two different dates:

Liabilities	*As on 31 December 1997*	*As on 31 December, 1998*
Profit and Loss A/c	50,000	80,000
Provision for Taxation	10,000	15,000
Proposed Dividends	5,000	10,000

On the basis of the above information Funds from Operations will be computed as follows in those case where 'Provision for Taxation' and 'Proposed Dividends' are taken as non-current liabilities.

	Rs
Balance of Profit and Loss A/c as on 31 December, 1997	80,000
Add: Provision for tax made during the year	15,000
Add: Proposed dividends	10,000
	1,05,000
Less: Balance of P. L. A/c as on 31 December, 1996	50,000
Funds from operations	55,000

While preparing a Funds Flow Statement for the year 1997, Rs 10,000 and Rs 5,000 will be shown as Application of Funds under the heads Tax paid and Dividends paid respectively.

A distinction has to be made between 'tax payable' and 'provision for taxation.' Provision for tax may or may not be taken as a current liability, but 'tax payable' will be taken as a current liability, since this is the amount due by way of tax after finalisation of tax assessment. Similarly, 'dividend payable' is a current liability since this is the amount which has to be paid by way of dividends to the shareholders.

Is depreciation a source of funds? Depreciation means decrease in the value of an asset due to wear and tear, lapse of time, obsolescence, exhaustion and accident. Depreciation is taken as an operating expense while calculating funds from operations. The accounting entries are:

(*i*) Depreciation A/c	Dr.
To Fixed Assets A/c	
(*ii*) Profit and Loss A/c	Dr.
To Depreciation	

Thus, effectively the Profit and Loss Account is debited while the Fixed Asset Account is credited with the amount of depreciation. 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 since it has already been charged to Profit but it does not decrease Funds from Operations. Depreciation should not, therefore, be taken as a 'Source of Funds'. If Depreciation were really a source of funds by itself, any enterprise could have improved its funds position at will by merely increasing the periodical depreciation charge.

However, depreciation can be taken as a source of funds in a *limited sense* because of there reasons:

(*i*) Depreciation finds its way into current assets through charging of overheads (including depreciation). The value of closing inventory may include depreciation of fixed assets as an element of cost.

(*ii*) Depreciation does not generate funds but it definitely saves funds. For example, if the business had taken the fixed assets on hire, it would have been required to pay rent for them. Since it owns fixed assets, it saves outflow of funds which would have otherwise gone out in the form of rent.

(*iii*) Depreciation reduces taxable income and therefore, income-tax liability for the period is reduced. This will be clear with the following example.

Particulars	*Case I* *Rs*	*Case II* *Rs*
Income before depreciation	75,000	75,000
Depreciation provided (*A*)	Nil	15,000
Taxable income	75,000	60,000
Income tax say at 50 per cent	37,500	30,000
Net Income after (*B*)	37,500	30,000
Net flow of funds after tax (*A*) + (*B*)	37,500	45,000

The above example shows that in Case *II*, the net flow of funds is more by Rs 7,500 as compared to Case *I*. This is because on account of depreciation charge being claimed as an expense, tax liability has been reduced by Rs 7,500 in case of Case *II*. It may therefore be said that true funds flow from depreciation is the opportunity saving of cash outflow through taxation.

The technique of preparing a Schedule of Changes in Working Capital and a Funds Flow Statement can be very well understood with the help of exhaustive illustrations given in the following pages.

7.14 COMPUTATION OF FUNDS FROM OPERATIONS

Illustration 7.13 From the following details finds out the funds from operations.

Particulars		*Rs*	*Particulars*		*Rs*
To Salaries		40,000	By Gross profit		1,00,000
To Rent		15,000	By Profit on sale of Building		
To Provision for bad debts		5,000	sold for	Rs 10,000	
To Preliminary expenses written off		10,000	book value	Rs 5,000	5,000
To Goodwill written off		5,000			
To Depreciation on machinery		5,000			
To Loss on sale of plant					
book value	Rs 10,000				
sold for	Rs 8,000	2,000			
To Provision for tax		5,000			
To Net Profit		18,000			
		1,05,000			1,05,000

NOTES

Check Your Progress

6. State whether the following statements are 'True' or 'False'.

(a) Purchase of stock-in-trade is an application of funds.

(b) A decrease in current liabilities increases working capital.

(c) Funds flow refers to change in long-term funds.

(d) The funds flow statement shows changes in the individual items comprising working capital.

(e) Funds flow analysis shows the position of business as on the closing date of business period.

(f) Working capital is the difference between fixed assets and current assets.

(g) Cash or credit sales increases the working capital.

(h) Purchase of fixed assets is a use of funds.

(i) Amortisation of preliminary expenses is a use of funds.

(j) Payment of dividends is a use of funds.

(k) For funds flow statement provision for taxation will be treated as an item of internal source.

NOTES

Solution:

COMPUTATION OF FUNDS FROM OPERATIONS

Particulars		*Rs*
Net Profit as per Profit and Loss Account		18,000
Add: Items which do not decrease funds from operations		
Provision for tax	(*i*) 5,000	
Loss on sale of plant	(*ii*) 2,000	
Depreciation	(*iii*) 5,000	
Goodwill written off	(*iv*) 5,000	
Preliminary expenses written off	(*v*) 10,000	27,000
		45,000
Less: Items which do not increase funds from operations:		
Profit on sale of buildings	(*vi*)	5,000
Funds from operations		40,000

Working Notes:

(*i*) Provision for tax is only an appropriation of profits and therefore, to find out funds from operations it will have to be added back. The amount of tax actually paid will be shown as a separate item under 'application of funds.'

(*ii*) The entry for loss on sale of plant is:

P. & L. A/c Dr.
To Plant A/c

Since both accounts are 'fixed', i.e., one a fixed liability and the other a fixed asset, there is no flow of funds.

(*iii*) Depreciation of machinery

P. & L. (Depreciation) A/c Dr.
To Machinery

Both accounts are 'fixed', therefore, there is no flow of funds.

(*iv*) and (*v*) also involve "fixed" accounts only.

(*v*) The entry for profit on sale of buildings.

Building A/c Dr.
To P. & L. A/c

Since both accounts are 'fixed' there is no flow of funds. Moreover, proceeds realised from sale of buildings Rs 10,000 will be taken as a separate source of funds. In case the item is considered here also, it will amount to considering it twice. Moreover, it is not an income or profit from operations.

7.14.1 Digging out Hidden Information

Sometimes the information required for Funds Flow Statement is not directly given in the question. It may have to be found out. For example, the question may give Opening Balance of Provision for Tax as Rs 10,000, Closing Balance of Provision for Tax as Rs 15,000 and Tax paid as Rs 12,000. In order to find out the Provision for Tax which must have been charged to Profit and Loss Account for the year, a Provision for Tax Account will have to be prepared in the following manner:

PROVISION FOR TAX ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Bank	12,000	By Balance b/d	10,000
To Balance c/d	15,000	By P.& L. A/c (balancing figure)	17,000
	27,000		27,000

NOTES

The Provision for Tax charged to Profit and Loss Appropriation Account for the year is Rs 17,000. In case the figure of Net Profit given is after tax, Rs 17,000 will have to be added back to Net Profit in order to find out funds from operations. On the same pattern, accounts may have to be prepared for dividends, plant, building to find out the hidden information.

Take another example. The Machinery Account gives a balance of Rs 1,00,000 in the beginning of the accounting year while at the end of the accounting year its balance is a sum of Rs 1,50,000. The provision for depreciation of the machinery stands at Rs 30,000 in the beginning of the accounting year and Rs 40,000 at the end of the accounting year. During the year, a machinery whose original cost was Rs 5,000 and on which depreciation of Rs 4,000 had been charged so far, is sold for Rs 2,000. In such a case, the amount of depreciation charged from the Profit and Loss Account on Machinery and the value of the Machinery purchased during the accounting year will be found out by preparing (*i*) Machinery Account, and (*ii*) Provision for Depreciation on Machinery Account as given below:

MACHINERY ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Balance b/d	1,00,000	By Bank	2,000
To Profit on sale of machinery	1,000	By Provision for depreciation	4,000
To Bank (Machinery purchased—Balancing figure)	55,000	By Balance c/d	1,50,000
	1,56,000		1,56,000

PROVISION FOR DEPRECIATION ON MACHINERY ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Machinery A/c	4,000	By Balance b/d	30,000
To Balance c/d	40,000	By Profit and loss A/c (Depreciation charged—balancing figure)	14,000
	44,000		44,000

Illustration 7.14 The Annual Accounts of Atlas Cycles Ltd. disclosed the following balances:

	31 March 1997	*31 March 1996*
Investments in other companies	28,000	34,000
Retained Surplus (P. & L. A/c)	67,500	57,000

The company had sold its 40 per cent interest in another company for a sum of Rs 23,500. There was a gain of Rs 13,500 on account of such sale and the amount was credited to Retained Surplus Account. State the sources and uses of company's fund.

Solution:

1. The company has investments in other companies. It has sold its interest in one of the companies for a sum of Rs 23,500. It has made a profit of Rs 13,500. It means cost of investment sold was Rs 10,000. The Investments on 31 March 1996 stood at Rs 34,000, out of which investments of Rs 10,000 have been sold away during the year. In the absence of any purchase of investment, the balance in the Investments Account should have been only Rs 24,000. However, it stands at Rs 28,000. This shows that investments have been purchased to the extent of Rs 4,000. It is an application of 'funds'.

The same results can be derived by preparing "Investments in other Companies Account."

NOTES

INVESTMENTS IN OTHER COMPANIES ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Balance b/d	34,000	By Bank (cost of investments sold)	10,000
To Bank (balancing figure)	4,000	By Balance c/d	28,000
	38,000		38,000

2. The gain on sale of investments of Rs 13,500 has been credited to the Retained Surplus account. Since the company is not trading in investments, the profit of Rs 13,500 should not have been taken to that account. The funds from operations for the year should, therefore, be calculated as follows:

Retained Surplus Balance as on 31 March, 1997	Rs 67,500
Less: Profit on sale of investments	13,000
	54,000
Less: Retained Surplus as on 31 March, 1996	57,000
Outflow of funds on account of operations	3,000

The above results can also be obtained by preparing a Retained Surplus Account.

RETAINED SURPLUS ACCOUNT

Particular	*Rs*	*Particular*	*Rs*
To Outflow of funds on account of operations (Balancing figure)	3,000	By Balance b/d	57,000
To Balance c/d	67,500	By Profit on sale of investments	13,500
	70,000		70,500

Funds flow statement can now be prepared as follows:

FUNDS FLOW STATEMENT

Particulars		*Rs*
Sources:		
Sale of Investments		23,500
	Total Sources	23,500
Applications:		
Purchase of Investments		4,000
Operational Loss		3,000
	Total Uses	7,000
Net Increase in Working Capital		16,500

7.15 COMPREHENSIVE FUNDS FLOW STATEMENTS

Illustration 7.15 From the following balance sheets of *X* Ltd. on 31 December, 1995 and 1996, you are required to prepare:

(*a*) A schedule of changes in working capital,

(*b*) A funds flow statement.

Liabilities	*1995 Rs*	*1996 Rs*	*Assets*	*1995 Rs*	*1996 Rs*
Share Capital	1,00,000	1,00,000	Goodwill	12,000	12,000
General Reserve	14,000	18,000	Building	40,000	36,000
Profit and Loss A/c	6,000	3,000	Plant	37,000	36,000
Sundry Creditors	8,000	5,400	Investments	10,000	11,000
Bills Payable	1,200	800	Stock	30,000	23,400
Provision for Taxation	16,000	18,000	Bills Receivable	2,000	3,200
Provision for Doubtful			Debtors	18,000	19,000
Debts	400	600	Cash/Bank	6,600	15,200
	1,55,600	1,55,800		1,55,600	1,55,800

NOTES

The following additional information has also been given:

(*i*) Depreciation charged on Plant was Rs 4,000 and on Building Rs 4,000.

(*ii*) Provision for taxation of Rs 19,000 was made during the year 1996.

(*iii*) Interim dividend of Rs 8,000 was paid during the year 1996.

Solution:

SCHEDULE OF CHANGES IN WORKING CAPITAL

Particular	*1995* *Rs*	*1996* *Rs*	*Increase (+)* *Rs*	*Decrease (–)* *Rs*
Current Assets:				
Cash at Bank6,600	15,200	8,600		
Debtors	18,000	19,000	1,000	
Bills receivable	2,000	3,200	1,200	
Stock	30,000	23,400		6,600
Current Liabilities:				
Provision for doubtful debts	400	600		200
Bills payable	1,200	800	400	
Sundry creditors	8,000	5,400	2,600	–
Total			13,800	6,800

Net Increase in working capital Rs 7,000.

FUNDS FLOW STATEMENT

Particulars		*Rs*
Source:		
Funds from Operations (*See* Note 1)		36,000
	Total Sources	36,000
Applications:		
Purchase of plant (*See* Note)		3,000
Tax paid (*See* Note 3)		17,000
Investments purchased (*See* Note 4)		1,000
Interim dividend paid		8,000
	Total Applications	29,000
Net Increase in Working Capital		7,000
		36,000

Working Notes:

1. Funds from operations:

Particulars	*Rs*	*Rs*
Profit and loss A/c balance on 31 December, 1996		13,000
Add: Items which do not decrease funds from operations		
Transfer to general reserve	4,000	
Provision for tax	19,000	
Depreciation:		
Plant	4,000	
Building	4,000	
Interim dividend paid	8,000	39,000
	52,000	
Add: Profit and Loss Account balance on 31 December, 1996		16,000
Funds from operations for the year		36,000

2. Purchase of Plant: This has been found out by preparing the Plant Account.

PLANT ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Balance b/d	37,000	By Depreciation	4,000
To Bank (Purchase of plant—balancing figure)	3,000	By Balance c/d	36,000
	40,000		40,000

3. Tax paid during the year has been found out by preparing a provision for tax account.

PROVISION FOR TAX ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Bank (being tax paid—Bal. figure)	17,000	By Balance b/d	16,000
To Balance c/d	18,000	By P. & L. A/c	19,000
	35,000		35,000

4. 'Investments' have been taken as a fixed asset presuming that they are long-term investments.

Illustration 7.16 From the information as contained in the statement of Income and the Balance Sheet of G.C. Ltd., you are required to prepare a Funds Flow Statement and to describe the significant developments revealed by the statement. You are also required to prepare a Statement of Working Capital showing increase and decrease in each component thereof:

A. STATEMENT OF INCOME AND RECONCILIATION OF EARNINGS FOR 1997

Particular	*Rs*	*Rs*
Net Sales		25,20,000
Less: Cost of sales	19,80,000	
Depreciation	60,000	
Salaries and wages	2,40,000	
Operating expenses	80,000	
Provision for taxation	88,000	24,48,000
Net Operating Profit		72,000
Non-recurring Income:		
Profit on sale of an item of equipment		12,000
	84,000	
Retained earnings (balance in Profit and Loss A/c brought forward)		1,51,800
		2,35,800
Dividend declared and paid during the year		72,000
Profit and Loss A/c balance as on 31 December, 1997		1,63,800

B. COMPARATIVE BALANCE SHEET

Liabilities	*As at 31 Dec.1996*	*As at 31 Dec.1997*	*Assets*	*As at 31 Dec.1996*	*As at 31 Dec.1997*
Capital	3,60,000	4,44,000	Fixed Assets:		
Surplus in P. & L. A/c	1,51,800	1,63,800	Land	48,000	96,000
Sundry Creditors	2,40,000	2,34,000	Building and Equipment	3,60,000	5,76,000
Outstanding Expenses	24,000	48,000	Current Assets:		
Income Tax payable	12,000	13,200	Cash	60,000	72,000
Accumulated Depreciation			Debtors	1,68,000	1,86,000
on building and equipment	1,20,000	1,32,000	Stocks	2,64,000	96,000
			Advances	7,800	9,000
	9,07,800	10,35,000		9,07,800	10,35,000

Cost of equipments sold was Rs 72,000.

NOTES

Check Your Progress

7. Select the most appropriate answer.
(i) Increase in a fixed asset due to purchase is
(a) Source of funds, (b) Use of funds, and (c) None.
(ii) Net Profit earned plus non-working capital expenses is equal to
(a) Fund provided by operations, (b) Use of funds, and (c) Sinking fund.
(iii) Tax paid is
(a) Application of fund, (b) Source of fund, and (c) No flow of fund.
(iv) Stock at the end results in the
(a) Application of fund, (b) Source of fund, (c) No flow of fund.
(v) Stock in the beginning results in
(a) Application of fund, (b) Source of fund, and (c) No flow of fund.
(vi) An increase in the share premium account is
(a) An application of fund, (b) A source of fund, and (c) No flow of fund.
(vii) Sale of long-term investments indicates
(a) Source of funds, (b) Application of funds, and (c) Change in current assets.

Solution:

FUNDS FLOW STATEMENT
for the year ended 31 December, 1997

Particulars	*Rs*	*Rs*
Sources:		
Issue of shares		84,000
Funds from operations:		
Trading profit		72,000
Depreciation	60,000	1,32,000
Sale of fixed assets (equipment)		36,000
Total Sources (*A*)		2,52,000

Particulars	*Rs*
Applications:	
Purchase of land	48,000
Purchase of building and equipments	2,88,000
Dividend paid	72,000
Total Applications (*B*)	4,08,000
Decrease in Working Capital (*A*) – (*B*)	1,56,000

NOTES

STATEMENT OF CHANGES IN WORKING CAPITAL

	Dec.1996 *Rs*	*Dec.1997* *Rs*	*Increase* *Rs*	*Decrease* *Rs*
Current Assets:				
Cash	60,000	72,000	12,000	
Debtors	1,68,000	1,86,000	18,000	
Stock	2,64,000	96,000		1,68,000
Advances	7,800	9,000	1,200	
	4,99,800	3,63,000	31,200	1,68,000
Current Liabilities:				
Sundry Creditors	2,40,000	2,34,000	6,000	
Outstanding Expenses	24,000	48,000		24,000
Income Tax Payable	12,000	13,200		1,200
	2,76,000	2,95,200	37,200	1,93,200
Working Capital	2,23,800	67,800		1,56,000

The chief development portrayed by the Funds Flow Statement is a big expansion in fixed assets financed by issue of shares, depreciation funds and the major part of working capital.

Working Notes:

(*i*) BUILDING AND EQUIPMENT ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Balance b/d	3,60,000	By Bank	36,000
To Profit and loss A/c	12,000	By Provision for depreciation	
To Bank (Purchases—balancing figure)	2,88,000	(on items sold)	48,000
		By Balance c/d	5,76,000
	6,60,000		6,60,000

(*ii*) PROVISION FOR DEPRECIATION ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Building and equipment A/c	48,000	By Balance b/d	1,20,000
(for item sold-balancing figure)		By Profit and loss A/c	60,000
To Balance c/d	1,32,000		
	1,80,000		1,80,000

NOTES

Since tax payable is a current liability, the amount of tax paid Rs 86,800 (i.e. Rs 12,000 + Rs 88,000 – Rs 13,200) has not been shown as application of funds in the Funds Flow Statement.

Illustration 7.17 Balance Sheets of M/s Black and White as on 1 January, 1997 and 31 December, 1997 were as follows:

BALANCE SHEETS

Liabilities	*1Jan. '97 Rs*	*31 Dec. '97 Rs*	*Assets*	*1 Jan. '97 Rs*	*31 Dec. '97 Rs*
Creditors	40,000	44,000	Cash	10,000	7,000
Mr. White's loan	25,000	–	Debtors	30,000	50,000
Loan from P.N. Bank	40,000	50,000	Stock	35,000	25,000
Capital	1,25,000	1,53,000	Machinery	80,000	55,000
			Land	40,000	50,000
			Building	35,000	60,000
	2,30,000	2,47,000		2,30,000	2,47,000

During the year machine costing Rs 10,000 (accumulated depreciation Rs 3,000) was sold for Rs 5,000. The provision for depreciation against machinery as on 1 January,1997 was Rs 25,000 and on 31 December, 1997 Rs 40,000. Net profit for the year 1997 amounted to Rs 45,000. You are required to prepare Funds (Working Capital) Flow Statement.

Solution:

FUNDS FLOW STATEMENT
for the year ending 31 December, 1997

Particulars	*Rs*
Sources:	
Loan from P.N. Bank	10,000
Sale of Plant	5,000
Funds from Operations (*See* Working Note 2)	65,000
Total Sources	80,000
Applications:	
White's Loan repaid	25,000
Partners' drawings	17,000
Purchase of land	10,000
Purchase of building	25,000
Total Applications	77,000
Increase in Working Capital	3,000

Working Notes:

1. SCHEDULE OF CHANGES IN WORKING CAPITAL

Particulars	*Increase Rs*	*Decrease Rs*
Cash	3,000	
Debtors	20,000	
Stocks		10,000
Creditors		4,000
	20,000	17,000
Increase in Working Capital	3,000	

2. FUNDS FROM OPERATIONS

	Rs
Profit made during the year	45,000
Add: Loss on sale of Machine sold	2,000
Depreciation on machinery	18,000
	65,000

3. MACHINERY ACCOUNT

Particulars	Rs	Particulars	Rs
To Balanceb/d	1,05,000	By Provision for Depreciation on machinery sold	3,000
		By Bank	5,000
		By Loss on machinery sold	2,000
		By Balance c/d	95,000
	1,05,000		1,05,000

4. PROVISION FOR DEPRECIATION ON MACHINERY

	Rs		Rs
To Machinery A/c	3,000	By Balance b/d	25,000
To Balance c/d	40,000	By P. and L. A/c (Depreciation provided during the year -Balancing figure)	18,000
	43,000		43,000

Illustration 7.18 From the following Balance Sheets of *KEROX* Ltd. prepare Funds Flow Statement for 1997:

(Rs in thousands)

Liabilities	*31 March 1996*	*31 March 1997*	*Assets*	*31 March 1996*	*31 March 1997*
Equity share capital	150	200	Goodwill	50	40
9 per cent redeemable preference shares	75	50	Land and buildings	100	85
			Plant	40	100
Capital reserve	–	10	Investments	10	15
General reserve	20	25	Sundry debtors	70	85
Profit and loss A/c	15	24	Stock	39	55
Proposed dividend	21	25	Bills receivable	10	15
Sundry creditors	13	24	Cash in hand	7	5
Bills payable	10	8	Cash in bank	5	4
Liability for expenses	15	18	Preliminary expenses	8	5
Provision for tax	20	25			
	339	409		339	409

Additional Information

(*i*) A part of land was sold out in 1997, and the profit was credited to capial reserve.

(*ii*) A machine has been sold for Rs 5,000 (written down value of the machine was Rs 6,000). Depreciation of Rs 5,000 was charged on plant in 1997.

(*iii*) An interim dividend of Rs 10,000 has been paid in 1997.

(*iv*) An amount of Rs 1,000 has been received by way of dividend on investment in 1997.

Solution:

FUNDS FLOW STATEMENT
for the year ended 31 March, 1997

Particulars	Rs	Particulars	Rs
Sources:		Applications:	
Issue of equity shares	50,000	Tax paid	20,000
Sale of land	25,000	Redemption of preference shares	25,000
Sale of machinery	5,000	Interim dividend paid	10,000
Dividend on investments	1,000	Investments purchased	5,000
Funds from operations	92,000	Dividend paid	21,000
		Plant purchased	71,000
		Increase in working capital	21,000
	1,73,000		1,73,000

NOTES

Check Your Progress

8. Examine the impact of the following transactions on the funds flow.
(a) Cash collected from debtors.
(b) Purchase of machinery by issue of debentures.
(c) Old furniture the book value of which is Rs 5,000 discarded and written off in the Profit and Loss Account.

9. State the reason whether the following transactions result in the increase or decrease of working capital or do not affect the working capital.
(a) A company issued 10,000 shares of Rs 10 each at par and fully paid up.
(b) Debentures for Rs 1,00,000 are converted into Equity shares.
(c) Investments were sold for Rs 50,000.
(d) Building was purchased for Rs 1,50,000.
(e) Bills payable accepted and issued to creditors Rs 40,000.
(f) Bills receivable Rs 10,000 discounted for Rs 9,500.
(g) Fixed assets purchased by issue of shares for Rs 1,00,000.
(h) Cash paid to creditors Rs 30,000.
(i) Preliminary expenses written off Rs 5,000.
(j) Advanced Income Tax paid Rs 50,000.

NOTES

Working Notes:

(*i*) SCHEDULE OF CHANGES IN WORKING CAPITAL
for the year ending 31 March, 1997

	Increase (+) *Rs*	*Decrease (–)* *Rs*
Sundry debtors	15,000	
Stock	16,000	
Bills receivable	5,000	
Cash in hand		2,000
Cash at bank		1,000
Liability for expenses		3,000
Bills payable	2,000	
Sundry creditors		11,000
	38,000	17,000

Net Increase in Working Capital Rs 21,000.

(*ii*) PLANT ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Balance b/d	40,000	By Bank	5,000
To Bank (Additions)	71,000	By P. & L. A/c	1,000
		By Provision for Depreciation	5,000
		By Balance c/d	1,00,000
	1,11,000		1,11,000

(*iii*) ADJUSTED PROFIT AND LOSS ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Provision for taxation	25,000	By Balance b/d	15,000
To Depreciation on machinery	5,000	By Dividend on investments	1,000
To Preliminary expenses	3,000	By Funds from operations	
To Goodwill written off	10,000	(balancing figure)	92,000
To General reserve	5,000		
To Proposed dividend	25,000		
To Interim dividend	10,000		
To Loss on sale of machinery	1,000		
To Balance c/d	24,000		
	1,08,000		1,08,000

(*iv*) INVESTMENTS ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Balance b/d	10,000	By Balance c/d	15,000
To Bank (Additions)	5,000		
	15,000		15,000

Alternative treatment

(*i*) Provision for tax may be taken as a current liability. In such a case the net increase in working capital will be only Rs 16,000. Funds from operations will amount to Rs 67,000. Tax paid will not then appears as Application of Funds.

(*ii*) If proposed dividend is also taken as a current liability, the working capital will further stand reduced to Rs 12,000. Funds from operations will be Rs 42,000 (i.e., Rs 67,000 – Rs 25,000).

The Funds Flow Statement will appear as follows:

NOTES

Particulars	*Rs*
Sources:	
Issue of equity shares	50,000
Sale of land	25,000
Sale of machinery	5,000
Dividend from investments	1,000
Funds from operations (after dividend and tax)	42,000
Total sources (*i*)	1,23,000
Applications:	
Redemption of redeemable preference shares	25,000
Interim dividend paid	10,000
Investments purchased	5,000
Plant purchased	71,000
Total applications (*ii*)	1,11,000
Increase in working capital (*i*) – (*ii*) Rs 12,000.	

Tutorial Note:

The students will find the former approach convenient. They may, therefore, adopt that approach.

Illustration 7.19 The Balance Sheets of *ABC* Co. Ltd. as at the end of 1996 and 1997 are give below:

Liabilities	*1996 Rs*	*1997 Rs*	*Assets*	*1996 Rs*	*1997 Rs*
Share capital	1,00,000	1,50,000	Freehold land	1,00,000	1,00,000
Share premium	–	5,000	Plant at cost	1,40,000	1,00,000
General reserve	50,000	60,000	Furniture at cost	7,000	9,000
Profit and loss A/c	10,000	17,000	Investments at cost	60,000	80,000
12 per cent debentures	70,000	50,000	Debtors	30,000	70,000
Precision for dep. on plant	50,000	56,000	Stock	60,000	65,000
Provision for Depreciation on furniture	5,000	6,000	Cash	30,000	45,000
Provision for Taxation	20,000	30,000			
Sundry Creditors	86,000	95,000			
	3,91,000	4,69,000		3,91,000	4,69,000

A plant purchased for Rs 4,000 (Depreciation Rs 2,000) was sold for cash for Rs 800 on 30 September 1997. On 30 June 1997, an item of furniture was purchased for Rs 2,000. These were the only transactions concerning fixed assets during 1997. A dividend of $22^1/_2$ per cent on original shares was paid.

Solution:

FUNDS FLOW STATEMENT

Particulars	*Rs*
Sources of Funds:	
Share capital (including premium)	55,000
Sale of plant	800
Funds from operations (*See* Note 2)	79,700
Total sources	1,35,500
Applications of Funds:	
Redemption of debentures	20,000
Purchase of furniture	2,000
Dividend paid	22,500
Investments purchased	20,000
Tax paid (*See* Note 1)	20,000
Total uses	84,500
Increase in Working Capital	51,000

NOTES

The increase in working capital can be verified by preparing a schedule of changes in working capital.

SCHEDULE OF CHANGES IN WORKING CAPITAL

Particulars	*1996 Rs*	*1997 Rs*	*Increase (+) Rs*	*Decrease (–) Rs*
Current Assets:				
Debtors	30,000	70,000	40,000	
Stock	60,000	65,000	5,000	
Cash	30,00	45,000	15,000	
Current Liabilities:				
Sundry Creditors	86,000	95,000		9,000
			60,000	9,000
Increase in Working Capital			51,000	

Working Notes:

1. Provision for taxation has been taken as a non-current liability. Moreover, in the absence of any specific instructions in the question, it is safe to presume that tax must have been paid equivalent to last year's provision for taxation.
2. Funds from operations have been calculated as follows:

ADJUSTED PROFIT AND LOSS ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Dividend paid	22,500	By Balance b/d	10,000
To Provision for taxation	30,000	By Funds from operations	
To Transfer to general reserve	10,000	(balance figure)	79,700
To Depreciation:			
Plant	8,000		
Furniture	1,000		
To Loss on sale of plant	1,200		
To Balance c/d	17,000		
	89,700		89,700

3. Loss on sale of Pant and Provisions for Depreciation on Plant and Furniture made during the year have been found out by preparing different accounts:

PLANT ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Balance b/d	1,04,000	By Bank	800
		By P. & L. (loss on sale of plant) A/c	1,200
		By Provision for depreciation	
		(on plant sold)	2,000
		By Balance c/d	1,00,000
	1,04,000		1,04,000

FURNITURE ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Balance b/d	7,000	By Balance c/d	9,000
To Bank (balancing figure)	2,000		
	9,000		9,000

PROVISION FOR DEPRECIATION ON FURNITURE ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Balance c/d	6,000	By Balance b/d	5,000
		By P. & L. A/c	1,000
		(depreciation charged for the	
		year-balancing figure)	
	6,000		6,000

NOTES

PROVISION FOR DEPRECIATION ON PLANT ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Plant A/c (dep. on plant sold)	2,000	By Balance b/d	50,000
To Balance c/d	56,000	By P. & L. A/c (Balancing figure-depreciation charged during the year)	8,000
	58,000		58,000

Illustration 7.20 From the following financial statements of Workwell Ltd., you are required to prepare:

(*i*) A Schedule of Changes in Working Capital, and

(*ii*) A Funds Flow Statement.

Particulars	*1996* *Rs*	*1997* *Rs*
Trading Profit (after providing for depreciation and current taxation)	45,000	70,000
Profit on sale of investments	—	2,000
	45,000	72,000
Less: Provision for taxation	27,700	45,000
	17,300	27,000
Balance of Profit brought forward from previous year	15,000	17,300
Income tax refund	—	4,000
	32,300	48,300
Proposed Dividend	15,000	15,000
	17,300	33,300
Transfer to General Reserve	—	10,000
Balance of retained earnings	17,300	23,300

BALANCE SHEET

Liabilities	*1996* *Rs*	*1997* *Rs*	*Assets*	*1996* *Rs*	*1997* *Rs*
Equity Share Capital	70,000	80,000	Fixed assets at cost	60,000	68,000
General Reserve	25,000	35,000	*Less*: Accumulated		
Profit and Loss A/c	17,300	23,300	depreciation	20,000	32,000
Future Taxation	20,000	32,000		40,000	36,000
	1,32,300	1,70,300	Current assets	3,20,000	4,18,500
Current Liabilities:					
Account Payable	1,93,000	2,39,200			
Current Taxation	19,700	30,000			
Proposed Dividend	15,000	15,000			
	3,60,000	4,54,500		3,60,000	4,54,500

Solution:

SCHEDULE OF CHANGES IN WORKING CAPITAL

Particulars	*Increase (+)* *Rs*	*Decrease (–)* *Rs*
Current Assets	98,500	
Account Payable		46,200
Current Taxation		10,300
Increase in Working Capital	—	42,000
	98,500	98,500

NOTES

FUNDS FLOW STATEMENT

Particulars	*Rs*
Sources:	
Issue of Shares	10,000
Funds from Operations (including profit on sale of investments)	69,000
Refund of Income Tax	4,000
Total Sources (*i*)	83,000
Applications:	
Purchase of Fixed Assets	8,000
Tax paid	33,000
Total Applications (*ii*)	41,000
Increase in Working Capital (*i*) – (*ii*)	42,000

Working Notes:

1. ADJUSTED PROFIT AND LOSS ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To General Reserve	10,000	By Balance b/d	17,300
To Depreciation	12,000	By Income-tax refund	4,000
To Provision for Tax (future)	45,000	By Funds from operations	
To Balance c/d	23,300	—(balancing figure)	69,000
	90,300		90,300

2. FUTURE TAXATION ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Bank (Tax Paid)	33,000	By Balance b/d	20,000
To Balance c/d	32,000	By P. & L. A/c	45,000
	65,000		65,000

3. Profit on account of sale of investments could have been shown as a separate 'Source of Funds' instead of including it as a part of funds from operations.
4. Total sale proceeds on account of sale of investments could not be found out in the absence of adequate information.
5. Income tax refund could have also been adjusted in Future Taxation Account. In such a case 'refund of tax' could not have been shown as a 'Source of Funds' and Rs 29,000 would have been shown as 'Tax paid'.

Illustration 7.21 The summarised Balance Sheet of *FF* Ltd. as on 31st March, 1995 and 31st March, 1996, were as follows:

Particulars	*1995* *Rs*	*1996* *Rs*
Sources of Funds:		
Share capital	6,00,000	8,00,000
General reserve	3,40,000	4,20,000
Profit & Loss A/c	20,000	50,000
15% Debentures-*A* series	4,00,000	–
14% Debentures-*B* series	–	5,00,000
Total	13,60,000	17,70,000

(*Contd.*)

Particulars	1995 Rs	1996 Rs
Applications of Funds:		
Fixed Assets at cost	16,00,000	19,00,000
Less: Depreciation to date	7,60,000	8,80,000
Net Fixed Assets (*A*)	8,40,000	10,20,000
Investments (*B*)	–	3,00,000
Sundry Debtors	2,00,000	2,00,000
Less: Provisions for doubtful debts	20,000	50,000
	1,80,000	1,50,000
Stocks	2,20,000	1,60,000
Cash and Bank Balances	1,80,000	2,20,000
Other Current Assets	72,000	96,000
Current Assets	6,52,000	6,26,000
Less: Current Liabilities	1,32,000	1,76,000
Net Current Assets (*C*)	5,20,000	4,50,000
Total (*A*) + (*B*) + (*C*)	13,60,000	17,70,000

NOTES

While going through the accounts, the following are noticed:

(*i*) Fixed assets of original cost of Rs 75,000 with book value of Rs 10,000 were scrapped and sold for Rs 5,000.

(*ii*) Included in current liabilities are proposed dividend figures:

	Rs
31.3.1995	60,000
31.3.1996	80,000

(*iii*) During the year interim dividend for Rs 45,000 was paid besides the outstanding as on 31.3.1996.

From the above you are required to prepare a statement of funds flow during 1995–96. (*CA Final, May 1991, adapted*)

Solution:

***FF* Ltd.**
FUNDS FLOW STATEMENT
for the year ended 31.3.1996

Particulars	Rs	Particulars	Rs
Sources:		*Applications:*	
Issue of shares	2,00,000	Redemption of 15% Debentures-*A* Series	4,00,000
Issue of 14% Debentures—*B* Series	5,00,000	Purchase of Fixed Assets	3,75,000
Sale of Fixed Assets	5,000	Purchase of Investments	3,00,000
Funds from Operations	4,25,000	Payment of Dividend for 1994–95	60,000
Decrease in Working Capital	50,000	Payment of Interim Dividend for 1995–96	45,000
	11,80,000		11,80,000

Working Notes:

1. STATEMENT OF CHANGES IN WORKING CAPITAL

Particulars	1995	1996	Change in Working Capital Increase (+)	Decrease (–)
Current Assets				
Sundry Debtors (*Less*: Provision)	1,80,000	1,50,000		30,000
Stock	2,20,000	1,60,000		60,000
Cash and bank balances	1,80,000	2,20,000	40,000	

(*Contd.*)

NOTES

Particulars	*1995*	*1996*	*Change in Working Capital Increase (+)*	*Decrease (–)*
Other current assets	72,000	96,000	24,000	
Other liabilities (excluding proposed dividend)	72,000	96,000		24,000
			64,000	1,14,000
Decrease in working capital			50,000	
			1,14,000	1,14,000

2. ADJUSTED PROFIT & LOSS ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Transfer to General Reserve	80,000	By Balance b/d	20,000
To Depreciation Provision	1,85,000	By Funds from Operations (balancing figure)	4,25,000
To Loss on sale of fixed assets	5,000		
To Proposed dividend (1995–96)	80,000		
To Interim dividend	45,000		
To Balance c/d	50,000		
	4,45,000		4,45,000

3. FIXED ASSETS ACCOUNT

	Rs		*Rs*
To Balance b/d	16,00,000	By Fixed Assets Disposal A/c	75,000
To Bank (Purchases-bal.figure)	3,75,000	By Balance c/d	19,00,000
	19,75,000		19,75,000

4. FIXED ASSETS DISPOSAL ACCOUNT

	Rs		*Rs*
To Fixed assets A/c	75,000	By Depreciation Provision A/c	65,000
		By Bank A/c (Sale proceeds)	5,000
		By Adjusted Profit & Loss A/c (Loss on disposal)	5,000
	75,000		75,000

5. DEPRECIATION PROVISION ACCOUNT

	Rs		*Rs*
To Fixed Assets Disposal A/c	65,000	By Balance c/d	7,60,000
To Balance c/d	8,80,000	By P.&L. A/c (Provn. for the year)	1,85,000
	9,45,000		9,45,000

6. Investments have been taken as long-term.

7. Proposed Dividends have been taken as non-current liabilities. Alternatively, they could have been taken as current liabilities also.

Illustration 7.22 Given below are the Balance Sheets of *A* Limited for a period of three years-as at 31st March each year:

Rs in lakhs

Liabilities Rs	*1995 Rs*	*1996 Rs*	*1997*	*Assets Rs*	*1995 Rs*	*1996 Rs*	*1997*
Share Capital-in-equity shares of Rs 10 each	30	35	35	Plant and Machinery	45	55	70
General Reserve	10	15	18	Investments	10	15	20
Surplus	5	8	9	Stock	12	15	15
13% Debentures	10	5	10	Debtors	14	15	12
Bank Credit	5	10	15	Cash and Bank	3	6.5	13
Trade Creditors	10	12	15				
Income Tax Provision for the current year	8	11	14				
Proposed Dividends	6	10.5	14				
	84	106.5	130		84	106.5	130

NOTES

Other details:

(*i*) Depreciation provided in-the books:

94–95	Rs 6	lakhs
95–96	Rs 8	lakhs
96–97	Rs 10	lakhs

(*ii*) A part of the Debentures was converted into equity at par in September 1996.

(*iii*) There was no sale of fixed assets during the period.

The management seeks your advice on the liquidity position of the company. You are to use the Funds Flow Statement for the purpose. (*CA Final, Nov. 1993*)

Solution:

(*a*) STATEMENT OF CHANGE IN WORKING CAPITAL

(Rs in lakhs)

	Particulars	*1994–95*	*1995–96*	*1996–97*
A	Current Assets:			
	Stock 12.0	15.0	15.0	
	Debtors 14.0	15.0	12.0	
	Cash and bank	3.0	6.5	13.0
	29.0	36.5	40.0	
B	Current Liabilities:			
	Bank Credit	5.0	10.0	15.0
	Trade Creditors	10.0	12.0	15.0
	15.0	22.0	30.0	
C	Working Capital (*A*) – (*B*)	14.0	14.5	10.0
D	Changes in Working Capital	–	+ 0.5	– 4.5

(*b*) STATEMENT OF FUNDS FROM OPERATIONS *(Rs in lakhs)*

Particulars	*1995–96*	*1996–97*
Increase in Surplus	3.0	1.0
Increase in General Reserve	5.0	3.0
Tax Provision	11.0	14.0
Proposed Dividends	10.5	14.0
Depreciation	8.0	10.0
Funds from Operations	37.5	42.0

(*c*) FUNDS FLOW STATEMENT

	1995–96	*1996–7*
Sources:		
Funds from operations	37.5	42.0
Issue of 13% debentures	–	5.0
	37.5	47.0
Applications:		
Purchase of plant and machinery	18.0	25.0
Purchase of investments	5.0	5.0
Tax payment	8.0	11.0
Dividend payment	6.0	10.5
	37.0	51.5
Changes in Working Capital	40.5	– 4.5

Comments

The Funds Flow Statements prepared for the year 1995–96 and 1996–97 disclose that funds generated from operations during these years were largely used for paying taxes and dividend. In 1995–96 about 37% of funds generated from operations were used to pay taxes and dividend. In the year 1996–97, this percentage increased to 51%.

NOTES

The dividend policy adopted by the company does not appear to be sound because it is not based on the liquidity position of the company. In 1996–97 the funds generated from operations were 12% more as compared to 1995–96. But, at the same time, the dividend rate was increased to 30% in 1995–96 as compared to 20% in 1994–95. The dividend of Rs 10.5 lakhs for 1995–96 was paid in 1996–97. This payment of dividend absorbed 25% of the total funds generated from operations in 1996–97. Moreover, the dividend rate was further hiked to 40% in 1996–97 in spite of poor working capital position. The tax paid to funds generated from operations also increased from 21% in 1995–96 to about 26% in 1996–97. This all shows that the company had not adopted a sound dividend policy.

In 1995–96, more than 60% of the total funds generated from operations were utilised for purchase of plant and machinery and investments. The balance of the funds was used for paying taxes and dividends, besides, leaving Rs 50,000 for the working capital business. However, in the year 1995–96 the situation was different. The total funds generated amounted to Rs 47 lakhs while the total applications amount to Rs 51.15 lakhs.

The investment in fixed assets (plant and machinery Rs 25 lakhs + investments Rs 5 lakhs) amounted to Rs 30 lakhs while long-term funds of only Rs 5 lakhs through debentures were raised. The rest of the requirements of the funds were made from funds from operations. The increase in dividend and tax payment resulted in overall deficit of Rs 4.5 lakhs in the working capital during 1996–97. Thus, on account of defective financial policies pursued by the company, the working capital position sharply deteriorated in 1996–97.

The company's current ratio has declined sharply from 1.93 in 1995–96 to 1.33 in 1996–97. The sharp decline in the current ratio is because of financing investment and fixed assets by short-term loans as discussed above. Of course, as per Chore Committee's recommendations, the current ratio of 1.33 is considered to be sufficient for obtaining working capital loans from bank. However, the position of the company is too risky and needs immediate improvement.

The company purchased investments of Rs 5 lakhs in 1996–97. In case these are trade investments the company's decision to purchase investments can be justified. However, if they are non-trade investments, it can be stated that the company has been following very unsound financial policy.

Assumptions

The following assumptions have been made while preparing the Funds Flow Statement:

1. The bank credit has been taken as short-term advance from the bank.
2. In the absence of information about the actual amount of dividend and tax paid, it has been presumed that the proposed dividend and tax provision for the current year were paid in the next year.

7.16 STATEMENT OF CHANGES IN FINANCIAL POSITION

'Statement of changes in Financial Position' is an extension of 'Funds Flow Statement'. It is very informative and comprehensive in indicating the firm's financial position, since the term 'Fund' is used here in a wider sense covering both current and non-current accounts. For example, when debentures are redeemed by converting them into share capital or when fixed assets are purchased by issue of fully paid shares to the vendors, there is no change in the working capital of the company but there is a change in the overall financial position of the company. These transactions do not find a place in the Funds Flow Statement, since there is no change in the funds position of the company.

NOTES

However, since they change the financial position of the company, they will be shown in the Statement of Changes in Financial Position both as Sources of Funds as well as Applications of Funds. Issue of shares to vendors for redemption of debentures will be shown as a Source of Funds while Redemption of Debentures or Purchase of Fixed Assets will be shown as an Application of Funds. Such a presentation gives a much more detailed as well as accurate information about the changes in the financial position of the company as compared to the changes in financial position as shown by the traditional Funds Flow Statement.

The importance of Statement of Changes in the Financial Position is now undoubtedly realised by all shareholders, management, lenders and others. In USA the publication of the Statement of Change in Financial Position as a part of Financial Statements has been made obligatory by the Accounting Principles Board. It states: 'Information concerning the financial and investing activities of a business enterprise and the changes in its financial position for a period is essential for financial statement users, particularly owners and creditors, in making economic decisions. When financial statements purporting to present both financial position (balance sheet) and results of operations (statement of income and retained earnings) are issued, a statement summarising changes in financial position should also be presented as a basic financial statement for the period for which an income statement is presented.'[3]

In our country, under the existing legal requirements, the companies are under no legal obligation to publish Statement of Changes in Financial Position along with their financial statements. However, there is a growing practice to publish such a statement along with financial statements especially in the case of companies listed on the stock exchange and other large commercial, industrial and business enterprises in the public and private sectors. As a matter of fact, the Institute of Chartered Accountants of India had issued Accounting Standard 3 dealing with the preparation and presentation of the Statement of Changes in Financial Position. Of course, the Standard has now been revised and titled as 'Cash Flow Statement'.

Definition A Statement of Changes in Financial Position may be defined as a statement of disclosing changes in the firm's total financial resources. According to International Accounting Standards Committee (International Accounting Standard No. 7) a Statement of Changes in Financial Position means 'A statement which summarises for the period the resources made available to finance the activities of an enterprise and the uses to which such resource have been put.'

The AS:3 issued by Accounting Standards Board established by the Institute of Chartered Accountants of India defined a Statement of Changes in Financial Position as 'A statement which summarises for the period covered by it, the changes in the financial position including the sources from which those were obtained by the enterprise and the specific uses to which funds were applied.'[4]

According to the Board, the term 'funds' generally refers to cash and cash equivalent or to working capital. Thus, according to the Board, the Statement of Changes in Financial Position may involve—(*i*) changes only in the firm's cash position, (*ii*) changes in the firm's working capital position, and (*iii*) changes in the firm's total financial resources position. Of course, the term 'Statement of Changes in Financial Position' is generally used in the last mentioned case.

Importance The statement of changes in financial position provides a meaningful link between the balance sheets at the beginning and at the end of a period and the profit and

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[3] 'Reporting Changes in Financial Position', Opinion No. 19, *AICPA*, 1971.

[4] AS 3 'Statement of Changes in Financial Position' has now been replaced by AS 3 (Revised) 'Cash Flow Statements.'

NOTES

loss account for that period. Although the information that it contains is a selection, reclassification and summarisation of the data contained in the profit and loss account and the balance sheets, it in is no way a replacement of either of these statements. To provide a comparative view of the movements of funds, the statement of changes in financial position is prepared for the period covered by the profit and loss account as well as for the corresponding previous period.

Preparation The information in the statement of changes in the financial position is generally identifiable with the items in the Balance Sheet, Profit and Loss Account and the related notes on accounts. However, it presents information which may not be readily available in usable form in these two statements. The following points are to be kept in view while preparing a statement of changes of the financial position:

(*i*) *Funds from operations to be shown separately*. Funds provided from the regular operations of an enterprise or applied to such operations are usually shown separately in the statement of changes in financial position. This may be done by adjusting the net profit (or loss) as per the profit and loss account for those items in the profit and loss account which to not cause a flow of funds, (e.g., depreciation). An alternative method is to begin with revenues that provided funds during the period and deduct the costs and expenses that involved a movement of funds. The resulting amount is described as funds from operations.

(*ii*) *Unusual movement of funds to be disclosed*. Unusual movements of funds, if material, are separately disclosed in the statement of changes in financial position just as unusual items are shown separately in the profit and loss account.

(*iii*) *Other sources and applications to be separately listed*. Other sources and applications of funds which are usually listed separately in the statement of changes in financial position include (but are not limited to):

(*a*) Proceeds from issue of shares capital;
(*b*) Redemption of preference share capital;
(*c*) Borrowings by way of term-loans;
(*d*) Repayment of term loans;
(*e*) Increase/decrease in bank borrowings for working capital (other than term loans);
(*f*) Increase/decrease in public deposits;
(*g*) Capital expenditure;
(*h*) Sale of fixed assets;
(*i*) Purchase/sale of investments;
(*j*) Dividends paid.

(*iv*) *Set-off or merger*. Individually important figures relating to the movements of funds are not ordinarily set-off or merged. However, if the amounts involved are not material, set-off or merger is resorted to e.g., capital expenditure may be shown net of fixed assets of small value disposed of during the period.

(*v*) *Exchange of one source for another*. Where a transaction involves the exchange of one source of funds for another, both aspects of the transaction are shown separately. For example, in the case of the conversion of term loans into equity, the issue of further equity and the cancellation/reduction of debt are shown separately.

Similarly, where a transaction involves both a financing and an investing aspect, e.g., issue of shares against acquisition of fixed assets, the two aspects of the transaction are usually separately disclosed.

(*vi*) *Other requirements*. The following are some of the other important requirements which were required by the Accounting Standard 3:

NOTES

(*a*) The Statement of Changes in Financial Position should be prepared along with the annual accounts.

(*b*) Such statements should be prepared and presented for the period covered by the Profit and Loss Account and for the corresponding previous period.

(*c*) Each enterprise should adopt the form of presentation for the Statement of Changes in the Financial Position which is most informative in the circumstances.

Illustration 7.23 From the following comparative Balance Sheet and Income Statement of *ABC* Ltd., prepare a Statement of Changes in Financial Position.

***ABC* Limited**
COMPARATIVE BALANCE SHEET
for the year ended 31 December 1995 and 1996

Particulars	*1996 Rs*	*1995 Rs*
Current Assets:		
Cash	60,000	50,000
Debtors	50,000	45,000
Stock (Inventory)	1,25,000	90,000
Total Current Assets	2,35,000	1,85,000
Fixed Assets:		
Land and Building	1,50,000	1,00,000
Plant and Machinery	2,20,000	2,00,000
Less: Accumulated Depreciation	(82,000)	(80,000)
Total Fixed Assets	2,88,000	2,20,000
Total Assets	5,23,000	4,05,000
Current Liabilities:		
Creditors	25,000	30,000
Salaries Payable	15,000	10,000
Provision for Tax	50,000	60,000
Provision for Dividend	40,000	40,000
Total Current Liabilities	1,30,000	1,40,000
Long-term Liabilities:		
Bank Loan	23,000	15,000
Debentures	1,20,000	1,50,000
Total long-term Liabilities	1,43,000	1,65,000
Total Liabilities	2,73,000	3,05,000
Owner's Equity:		
Share Capital	1,75,000	75,000
Share Premium	12,500	7,500
Reserves and Surplus	62,500	17,500
	2,50,000	1,00,000
Total Equities	5,23,000	4,05,000

***ABC* Ltd.**
INCOME STATEMENT
for the year ended 31 December, 1996

		Rs
Sales		5,00,000
Less: Cost of goods sold		2,10,000
Gross Profit		2,90,000
Less: Operating Expenses:		
Office and Administration Expenses	45,000	
Selling and Distribution	25,000	

(*Conmtd.*)

NOTES

		Rs
Interest	12,000	
Depreciation	22,000	1,04,000
Operating Profit		1,86,000
Add: Gain on sale of plant		6,000
Total profit		1,92,000
Less: Income-tax		85,000
Net profit		1,07,000

Additional Information

1. During the year plant Rs 50,000 (accumulated depreciation Rs 20,000) was sold.
2. The debentures of Rs 30,000 were converted into share capital at par.
3. The company declared a cash dividend of Rs 40,000 and a stock dividend of Rs 20,000 for the year.
4. The company issued 5,000 additional shares, par value of Rs 10 per share, at a premium of 10 per cent during the year.

Solution:

STATEMENT OF CHANGES IN FINANCIAL POSITION

	Rs
Sources:	
Funds from Operations	1,21,000
Sale of Plant	36,000
Loan from Bank	8,000
Issue of Shares:	
for cash	55,000
as stock dividend*	20,000
to convert debentures*	30,000
(*A*)	2,70,000
Applications:	
Purchase of Land Buildings	50,000
Purchase of Plant and Machinery	70,000
Payment of Dividend:	
in cash	40,000
as stock*	20,000
Redemption of debentures by conversion into shares*	30,000
(*B*)	2,10,000
Increase in Working Capital (*A*) – (*B*)	60,000

*These items do not find place in a Funds Flow Statement. However, they have to be shown in the Statement showing Changes in Financial Position as they affect the overall financial position of the company.

Working Notes:

ADJUSTED RESERVES AND SURPLUS ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Proposed Dividend	60,000	*By Balance b/d	17,500
To Accumulated Depreciation A/c	22,000	By Plant and Machinery A/c	
To Balance c/d	62,500	(profit on sale)	6,000
		By Funds from Operations	
		(balancing figure)	1,21,000
	1,41,500		1,41,500

*Proposed dividend has been added back to find out real funds from operations.

NOTES

PLANT AND MACHINERY ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Balance b/d	2,00,000	By Accumulated Depreciation A/c	20,000
To Adjusted Reserves and Surplus A/c	6,000	By Cash (sale)	36,000
To Cash (purchase-bal. figure)	70,000	By Balance c/d	2,20,000
	2,76,000		2,76,000

ACCUMULATED DEPRECIATION ACCOUNT

Particulars	*Rs*	*Particulars*	*Rs*
To Plant A/c	20,000	By Balance b/d	80,000
To Balance b/d	82,000	By Adjusted reserves and surplus A/c (Depreciation)	22,000
	1,02,000		1,02,000

Illustration 7.24 The Balance sheet of *A* Ltd as on 31st March, 1996 and the consolidated Balance Sheet of *A* Ltd. and its subsidiary *B* Ltd. as on 31st March, 1997 were as follows:

(Rs in lakhs)

Liabilities	*As at 31.3.96*	*As at 31.3.97*	*Assets*	*As at 31.3.96*	*As at 31.3.97*
Equity share capital			Goodwill	–	50.0
(of Rs 10 per share)	500.0	675.0	Land and Buildings	650.0	650.0
Reserves and Surplus	850.0	1,175.0	Plant and Machinery	625.0	1,617.5
Term Loans	300.0	425.0	Stock	275.0	375.0
Minority Interest	–	175.0	Debtors	225.0	420.0
Creditors	275.0	600.0	Cash	150.0	5.0
Bank Overdraft	–	67.5			
	1,925.0	3,117.5		1,925.0	3,117.5

Further Information:

A Ltd. had acquired 75% of the equity shares of *B* Ltd. on 1.9.96. At that date, the Assets and Liabilities of *B* Ltd were:

	(*Rs in lakhs*)
Fixed Assets	625
Stock	75
Debtors	100
Cash	125
Term Loans	125
Creditors	200

A Ltd. had paid Rs 500 lakhs to acquire the shares in *B* Ltd. This was made up of an issue of shares valued at 437.5 lakhs. Balance consideration was met from cash. The share premium on the issue of shares stood included in the reserves.

Depreciation charged in the consolidated accounts amounted to Rs 125 lakhs, as to building Rs 25 lakhs and as to plant and machinery Rs 100 lakhs.

A Ltd. paid an interim dividend of Rs. 50 lakhs on 1.3.97. On the same date *B* Ltd paid an interim dividend of Rs 25 lakhs.

Prepare a Consolidated Statement of Sources and Application of Funds with relevant workings.

NOTES

Solution:

CONSOLIDATED FUND FLOW STATEMENT

for the year ended 31st March, 1997 (Rs in lakhs)

Sources	*Rs*	*Application*	*Rs*
Issue of Shares at Premium for purchase of business of *B* Ltd.	437.50	Purchase of fixed assets (*WN* 3)	1117.50
Funds from Operations [*WN* 2]	268.75	Payment of Dividend by *A* Ltd.	50.00
Loans	125.00	Payment of Dividend to Minority Shareholders in *B* Ltd	6.25
Minority Interest [*WN* 1(b)]	150.0	Payment of Goodwill	50.00
Decrease in Working Capital [*WN* 1(*a*)]	242.50		
	1223.75		1223.75

Working Notes:

(*Rs in lakhs*)

1. *Minority Interest*		
(*a*) Minority Interest at the date of acquisition		
Assets:		
Fixed assets	625	
Stock	75	
Debtors	100	
Cash	125	925
Liabilities:		
Term loans	125	
Creditors	200	325
Net assets on 1.9.96		600
Less: Minority interest on 1.9.96 (25/100 × 600)		150
A's share capital and capital profits of *B* Ltd. at the date of acquisition		450
Purchase consideration		500
Payment of Goodwill		50
(*b*) Minority Interest on date of consolidation		175
Minority Interest on date of acquisition (shown as source)		150
Minority's share in post-acquisition profits of *B* Ltd (added to 'funds from operations')		25

2. *Funds from operations*

Increase in Reserves and Surplus (1175 – 850)		325.00
Less: On account of Share Premium (shown separate as source)		262.50
		62.50
Add: Depreciation	125.00	
Dividend paid by *A* Ltd. (shown separately as application)	50.00	
Dividend paid by *B* Ltd. to minority shareholders (25/100 × 25) (shown separately as application)	6.25	181.25
		243.75
Add: Share of Minority Shareholders of *B* Ltd. in the Post-acquisition Profits		25.00
		268.75

3. *Purchase of Fixed Assets*

	Opening Balance	*Depreciation*		*Closing Balance*	*Additions*
	(*a*)	(*b*)	(*c*) = (*a*) – (*b*)	(*d*)	(*d*) – (*c*)
Land and Buildings	650	25	625	650	25.0
Plant and Machinery	625	100	525	1617.5	1092.5
					1117.5

4. SCHEDULE OF CHANGES IN WORKING CAPITAL

	31.3.96	31.3.97	*Increase*	*Decrease*
Current Assets:			(+)	(–)
Stock	275.0	375.0	100	
Debtors	225.0	420.0	195	

(*Contd.*)

	31.3.96	31.3.97	Increase	Decrease
Cash	150.0	5.0		145
	650.0	800.0		
Current Liabilities:				
Creditors	275.0	600.0	–	325
Bank Overdraft	–	67.5	–	67.5
Working Capital	275.0	667.5	295	537.5
Decrease in Working Capital		242.5		242.5

Tutorial Note:

Please note that the amount of Goodwill (excess of purchase consideration over the amount of *A*'s share of share capital and capital profits of *B* Ltd.) at the date of acquisition is same as the amount at the date of consolidation. Hence, it is clear that dividend received from *B* Ltd. was credited by *A* Ltd. to its Profit and Loss Account as dividend out of post-acquisition profits of *B* Ltd.

NOTES

7.17 KEY TERMS

- **Cash:** The term stands for cash and demand deposits with banks.
- **Cash Equivalents:** The term includes short-term highly liquid investments that are readily convertible into a known amount of cash and which is subject to insignificant risk or change in values.
- **Cash Flow Analysis:** A technique involving analysis of the causes of flows of cash from one period to another.
- **Cash Flow Statement:** A statement depicting the change in cash position from one period to another.
- **Current assets.** Cash and other assets that are expected to be converted into cash or consumed in the production of goods or rendering of services in the normal course of business.
- **Current liabilities.** Liabilities payable within a year either out of the existing current assets or by creation of other current liabilities.
- **Funds.** It refers to working capital of a business.
- **Funds flow statement.** A statement summarising inflows and outflows of funds from any business activity.
- **Working capital.** It represents excess of current assets over current liabilities.

7.18 SUMMARY

In this unit, you have learned that:

- Cash flow statement describes the inflows (sources) and outflows (uses) of cash and cash equivalents during a specified period of time.
- AS 3 (Revised) classifies the cash flows in a period in the following three categories: (a) cash flows from operating activities; (b) cash flows from investing activities; and (c) (deducting) cash flows from financing activities.
- Net increase (decrease) in cash and cash equivalents is arrived at by adding (deducting) the cash inflows (outflows) during a particular period. The cash and cash equivalents at the beginning of the accounting period is added to the amount computed as above to ascertain the amount of cash or cash equivalents at the end of the accounting period.
- The term 'funds' refers to working capital of the business. Working capital denotes excess of current assets over current liabilities.

NOTES

- The term 'flow of funds' means change in working capital. In other words, any increase or decrease in working capital means flow of funds.
- There will be a flow of funds only when there is a cross transaction, i.e., transaction involving current liabilities or assets with non-current liabilities or non-current assets.
- Schedule of changes in working capital can be prepared only on the basis of a balance sheet. The additional information relating to current assets and current liabilities is of no consequence for this purpose.
- The results shown by the schedule of changes in working capital can be checked with the funds flow statement.
- Depreciation is not a source of funds. However, it is added back to operating profit to find out funds from operations.

7.19 ANSWERS TO 'CHECK YOUR PROGRESS'

1. (*a*) True, (*b*) False, (*c*) False, (*d*) False, (*e*) True, (*f*) False
2. (*i*) (*a*), (*ii*) (*a*), (*iii*) (*a*)
3. When funds denote working capital, none of the items will affect the working capital. When funds denotes 'Cash', items (*a*) will result in decrease of cash while items (*b*) and (*c*) will have no effect on cash.
4. Cash basis of accounting.
5. (*a*) working, (*b*) a source, (*c*) does not result, (*d*) an application, (*e*) deducted, (*f*) working capital, (*g*) a source
6. (*a*) False, (*b*) True, (*c*) False, (*d*) False, (*e*) Flase, (*f*) False, (*g*) True, (*h*) True, (*i*) False, (*j*) True, (*k*) True
7. (*i*) *b*, (*ii*) *a*, (*iii*) *a*, (*iv*) *b*, (*v*) *a*, (*vi*) *b*, (*vii*) *a*
8. None of the transactions will affect funds flow
9. (*a*) Increase (*b*) No effect (*c*) Increase (*d*) Decrease (*e*) No effect (*f*) Decrease by Rs 500 (*g*) No effect (*h*) No effect (*i*) No effect (*j*) Decrease].

7.20 QUESTIONS AND EXERCISES

1. Explain the meaning of a Cash Flow Statement. Discuss its utility.
2. Explain the technique of preparing a Cash Flow Statement with imaginary figures.
3. Distinguish between Funds Flow Statement and Cash Flow Statement.
4. What is a Cash Flow Statement?
5. What is a 'Funds Flow Statement'? Examine its managerial uses.
6. 'A Funds Flow Statement is a better substitute for an Income Statement.' Discuss.
7. Explain the various concepts of funds in the context of Funds Flow Analysis.
8. What do you understand by Funds Flow Statements? How are they prepared? What are their uses?
9. What are the chief advantages of Funds Flow Statement? Also describe its limitations.
10. (*a*) 'Funds' flow analysis represents a 'stock to flow linkage.' Justify.
    (*b*) 'The true funds flow from depreciation is the opportunity saving of cash outflow through taxation.' Illustrate with a numerical example.
11. Distinguish between
    (*i*) Statement showing changes in working capital, and (*ii*) Funds Flow Statement.
12. (*a*) What type of transaction will not be reflected in the Statement of Sources and Application of Funds?
    (*b*) What do you understand by Funds generated within a company and funds available from outside a company?
    (*c*) Distinguish between a Funds Flow Statement and a Balance Sheet?
13. Write short notes on:
    (*i*) Application of Funds
    (*ii*) Importance of Funds Flow Statement.
    (*iii*) Statement of Changes in Financial Position

7.21 PRACTICAL PROBLEMS

NOTES

Cash from Operations

1. Compute cash from operations from the following figures:

(*i*) Profit for the year 1993 is a sum of Rs 10,000 after providing for depreciation of Rs 2,000.

(*ii*) The current assets for the business for the year ending 31 Dec., 1992 and 1993 are as follows:

Particulars	*31 Dec., 1992* *Rs*	*31 Dec., 1993* *Rs*
Sundry debtors	10,000	12,000
Provision for doubtful debts	1,000	1,200
Bills receivable	4,000	3,000
Bills payable	5,000	6,000
Sundry creditors	8,000	9,000
Inventories	5,000	8,000
Short-term investments	10,000	12,000
Outstanding expenses	1,000	1,500
Prepaid expenses	2,000	1,000
Accrued income	3,000	4,000
Income received in advance	2,000	1,000

[**Ans.** Cash from Operations Rs 7,700]

2. From the following Profit and Loss Account, you are required to compute cash from operations:

PROFIT AND LOSS ACCOUNT
for the ending 31 December, 1994

Particulars	*Rs*	*Particulars*	*Rs*
To Salaries	5,000	By Gross Profit	25,000
To Rent	1,000	By Profit on sale of Land	5,000
To Depreciation	2,000	By Income tax Refund	3,000
To Loss on sale of plant	1,000		
To Goodwill written off	4,000		
To Proposed Dividends	5,000		
To Provision for Taxation	5,000		
To Net Profit	10,000		
	33,000		33,000

[**Ans.** Cash from Operations Rs 19,000]

Simple Cash Flow Statement

3. The following is the summarised Balance Sheet M/s Rahul Brother Private Ltd. March, 1994 and 1995.

Liabilities	*1994* *Rs*	*1995* *Rs*	*Assets*	*1994* *Rs*	*1995* *Rs*
12% Redeemable			Fixed Assets	4,100	4,000
Preference Shares	—	1,000	*Less:* Depreciation	1,100	1,500
Equity Shares	4,000	4,000		3,000	2,500
	4,000	5,000	Debtors	2,000	2,400
General Reserve	200	200	Stock	3,000	3,500
Profit and Loss A/c	100	120	Prepaid Expenses	30	50
Debentures	600	700	Cash	120	350
Creditors	1,200	1,100			
Provision for Taxation	300	420			
Proposed Dividend	500	580			
Bank Overdraft	1,250	680			
	8,150	8,800		8,150	8,800

You are required to prepare a Statement of Cash Flow.

[**Ans.** Cash from Operations Rs 400, Sources Rs 1,600, Applications Rs 800]

NOTES

Comprehensive Cash Flow Statement

4. Wearwell Ltd. supplies you the following Balance Sheet on 31 December:

Liabilities	*1994 Rs*	*1995 Rs*	*Assets*	*1994 Rs*	*1995 Rs*
Share capital	70,000	74,000	Bank balance	9,000	7,800
Bonds	12,000	6,000	Receivable	14,900	17,700
Accounts payable	10,360	11,840	Inventories	49,200	42,700
Provision for			Land	20,000	30,000
doubtful debts	700	800	Goodwill	10,000	5,000
Reserves & surplus	10,040	10,560			
	1,03,100	1,03,200		1,03,100	1,03,200

Following additional information has also been supplied to you:

(*i*) Dividends amounting to Rs 3,500 were paid during the year 1994.

(*ii*) Land was purchased for Rs 10,000.

(*iii*) Rs 5,000 were written off on Goodwill during the year.

(*iv*) Bonds of Rs 6,000 were paid during the course of the year. You are required to prepare a Cash Flow Statement.

[**Ans.** Cash from Operations Rs 14,300, Sources Rs 18,300, Applications 19,500]

5. Tiny Tot Limited furnishes you with the following Balance Sheets for the year ending on 31 December, 1994 and 1995. You are required to prepare a Cash Flow Statement for year ended 31 December, 1995.

Liabilities	*1994 Rs*	*1995 Rs*	*Assets*	*1994 Rs*	*1995 Rs*
Equity Share Capital	10,000	10,000	Goodwill	1,200	1,200
General Reserve	1,400	1,800	Land	4,000	3,600
Profit and Loss A/c	1,600	1,300	Building	3,700	3,600
Sundry Creditors	800	540	Investments	1,000	1,100
Outstanding Exps.	120	80	Inventories	3,000	2,340
Prov. for Taxation	1,600	1,800	Receivables	2,000	2,220
Prov. for Bad Debts	40	60	Bank balance	660	1,520
	15,560	15,580		15,560	15,580

Following additional information has also been supplied to you:

(*i*) A piece of land has been sold for Rs 400.

(*ii*) Depreciation amounting to Rs 700 has been charged on building.

(*iii*) Provision for taxation has been made for Rs 1,900 during the year.

[**Ans.** Cash from Operations Rs 2,860, Sources Rs 3,260, Application Rs 2,400]

6. The Balance Sheets of *T* Ltd. as on 31 December, 1995 and 31 December, 1996 are as follows:

Liabilities	*1995 Rs*	*1996 Rs*	*Assets*	*1995 Rs*	*1996 Rs*
Share Capital	300.00	300.00	Freehold Property (at cost)	225.00	240.00
Reserves	255.00	240.00	Plant and Machinery	135.00	165.00
16 per cent Debentures	75.00	75.00	(at cost less depreciation)		
(unsecured)			Investments in Shares of		
Mortgage on			companies under the		
Freehold Property	27.00	14.25	same management	150.00	150.00
Creditors	45.00	45.00	(unquoted)		
Proposed Div. (subject			Investments in Shares of		
to ded. of tax)	22.00	23.25	other companies (quoted)	112.50	112.50
Provision for Taxation	21.00	37.50	(Market Value 1996		
Secured Overdraft (by a	15.00	82.50	Rs120 lakhs, 1995		
floating charge on			Rs 150 lakhs		
assets)			Stock	52.50	75.00
			Debtors	45.00	75.00
			Bank	10.50	—
	730.50	817.50		730.50	817.50

NOTES

The following additional information for the year 1996 is relevant:

	Rs
(1) Credit Sales	675 lakhs
(2) Credit Purchases	520 lakhs
(3) Overheads	83.75 lakhs
(4) Depreciation on Plant and Machinery	17.50 lakhs
(5) Dividend for 1995 was paid in full	
(6) Amount paid towards taxation for the year 1995	21.50 lakhs

In view of credit squeeze, the company has been asked by the Bank to reduce the overdraft substantially within six months, if possible by 50 per cent.

You are required to prepare a cash flow statement and briefly comment on the financial position of the company and suggest remedial measures to overcome the financial crisis.

[**Ans.** Cash from Operations Rs 41.25 lakhs. Applications Rs 119.25 lakhs.

Operations is the only source. Company has a safe financial position as far as long-term financial solvency is concerned, it is rather unduly conservative. Current ratio is extremely poor. ROI before interest and tax is 22.62 per cent which is quite satisfactory. The company can improve its current ratio by disposing of a part of quoted shares in other companies or converting a part of bank overdraft in a term loan]

7. The Mismanagement Ltd. always finds that it is hard pressed for funds. In spite of borrowing funds at high rate from banks they are not able to make payments to suppliers in time.

The financial position of the company as reflected from the balance sheet for the last two years is as under:

BALANCE SHEET

	1993		*1994*	
	Rs	*Rs*	*Rs*	*Rs*
Share Capital (Rs 10 fully paid)	10.00		10.00	
Profit and Loss A/c	1.65		0.45	
Bank Overdraft	1.55		5.95	
Sundry Creditors	1.00		6.00	
	14.20		22.40	
Land and Buildings	3.00			5.00
Plant and Machinery	5.00		6.00	
Less: Depreciation	1.20	3.80	1.80	4.20
Motor Cars	1.00		1.30	
Less: Depreciation	0.40	0.60	0.60	0.70
Stock		2.20		7.20
Sundry Debtors		4.60		5.30
		14.20		22.40

The following further information has been given:

(*a*) Dividend was paid during the year ended 31 December, 1994 at the rate of 10 per cent.

(*b*) The company had sold a motor van during the year 1994 for Rs 8,000. This was purchased for Rs 10,000 and its depreciated value in the books as on 1 January, 1994 was Rs 5000.

You are required to prepare a Cash Flow Statement.

8. A company finds on 1 January, 1995 that it is short of funds with which to implement its programme of expansion. On 1 January, 1994, it had a credit balance of Rs 1,80,000. From the following information, prepare a statement for the board of directors, to show how the overdraft of Rs 68,750 as at 31 December, 1994 has arisen:

Figures as per Balance Sheets as at 31 December of each year are as follows:

	1993 *Rs*	*1994* *Rs*
Fixed Assets	7,50,000	11,20,000
Stock and Stores	1,90,000	3,30,000
Debtors	3,80,000	3,35,000
Bank balance (Cr.)	1,80,000 (Overdraft)	68,750
Trade Creditors	2,70,000	3,50,000
Share Capital (in shares of Rs 10 each)	2,50,000	3,00,000
Bills Receivable	87,500	95,000

NOTES

The Profit for year ended 31 December, 1994, before charging depreciation and taxation amounted to Rs 2,40,000. The 5,000 shares were issued on 1 January, 1994, at a premium of Rs 5 per share. Rs 1,37,500 were paid in March, 1994, by way of income tax. Dividend was paid as follow: 1993 (final)—on the capital on 31 December, 1993 at 10 per cent *less* tax at 25 per cent. 1994 (interim)—5 per cent free of tax.

[**Ans.** Cash from Operations Rs 2,17,500; Sources Rs 2,92,500; Applications Rs 5,41,250]

[**Hint.** Final dividend paid is Rs 18,750 (i.e., Rs 25,000 *less* Tax of Rs 6,250); Income tax payable to the Government on account of dividend is Rs 11,250 i.e., 6,250 + Rs 5,000 on interim dividend free of tax); assume tax paid of Rs 1,37,500 includes this tax also]

9. The directors of Maheswari Brothers Private Ltd., are alarmed at the deterioration of the financial position of their company. They find that the overdraft is at the limit allowed by the bank and that they do not have sufficient funds to pay their creditors on the due dates. They are at a loss to understand why, when their accounts show satisfactory profits, they should be short of funds.

You are given the Balance Sheet of the Company as on 31 March, 1995 and 1996.

You are required to prepare a statement which will show what has happened to the money which has come into the business during the year.

BALANCE SHEET

	31 March, 1995 Rs		31 March, 1996 Rs	
Share Capital:				
Shares of Rs 10 each fully paid		5,00,000		5,00,000
Reserve and Surplus		30,000		40,000
Bank Overdraft		80,000		3,00,000
Sundry Creditors		1,00,000		3,00,000
		7,10,000		11,40,000
Land and Buildings		1,50,000		2,50,000
Plant and Machinery	2,50,000		3,00,000	
Less: Depreciation	60,000	1,90,000	90,000	2,10,000
Motor Vehicles	58,000		62,000	
Less: Depreciation	28,000	30,000	42,000	20,000
Stock		1,10,000		3,60,000
Sundry Creditors		2,30,000		3,00,000
		7,10,000		11,40,000

During the year a dividend of 10 per cent was distributed to the shareholders.
On 1 April, 1995 a motor car whose original cost was Rs 10,000 and depreciated to a book value of Rs 6,000 was sold for Rs 8,000.

[**Ans.** Cash Outflow on account of Operations Rs 14,000; Sources Rs 8,000; Applications Rs 2,28,000]

Funds Flow and Cash Flow Statements

10. From the following particulars, prepare Cash Flow and Funds Flow Statements of Mr. Kumar.

BALANCE SHEET

Liabilities	*31.12.92 Rs*	*31.12.93 Rs*	*Assets*	*31.12.92 Rs*	*31.12.93 Rs*
Loan	—	25,000	Cash	5,000	4,000
Current Liabilities	35,000	40,000	Debtors	40,000	45,000
Bank O.D.	40,000	30,000	Stock	30,000	25,000
Capital	1,50,000	1,54,000	Land	30,000	40,000
			Building	50,000	55,000
			Machinery	70,000	80,000
	2,25,000	2,49,000		2,25,000	2,49,000

During the year, Mr. Kumar brought additional capital of Rs 10,000 and his drawings during the year were Rs 31,000. Provision for depreciation on machinery—opening balance Rs 30,000, closing balance Rs 40,000. No depreciation need be provided on other assets.

[**Ans.** Total Sources of Cash Rs 40,000; Total Application of Cash Rs 66,000; Cash from Operations Rs 40,000; Total Sources of Funds 70,000;

Total Applications of Funds Rs 66,000; Increase in working Capital Rs 40,000; Funds from Operations Rs 35,000]

11. The following are the Balance Sheets of a Company as on 31 December, 1992 and 31 December, 1993:

Liabilities	*1992 Rs*	*1993 Rs*	*Assets*	*1992 Rs*	*1993 Rs*
Equity Share Capital	7,00,000	8,00,000	Fixed Assets	5,00,000	6,00,000
General Reserve	4,50,000	6,00,000	Additions	1,00,000	80,000
Profit and Loss A/c	1,73,000	2,33,000		6,00,000	6,80,000
Current Liabilities:			Depreciation	2,00,000	3,20,000
Trade Creditors	7,00,000	9,00,000		4,00,000	3,60,000
Bank Overdraft	11,50,000	14,00,000	Investments	1,20,000	
Creditors for Exps.	80,000	92,000	Current Assets:		
Prov. for Taxation	1,97,000	3,70,000	Debtors	13,00,000	21,85,000
Proposed Dividends	1,50,000	1,50,000	Stock at cost	17,80,000	20,00,000
	36,00,000	45,45,000		36,00,000	45,45,000

NOTES

The profit for the year 1993 as per Profit and Loss Account after providing for depreciation amounted to Rs 7,00,000 which was further adjusted as follows:

		Rs
P. & L. Balance b/f		1,73,000
Profit after Depreciation		7,00,000
Add: Profit on sale of Investments		20,000
	Rs	8,93,000
Less: Provision for Taxation	3,60,000	
Transfer to Reserve	1,50,000	
Proposed Dividend	1,50,000	6,60,000
Balance c/f		2,33,000

You are informed that

(*i*) The sales and purchases of the year 1993 amounted to Rs 80,00,000 and Rs 65,00,000 respectively.

(*ii*) In arriving at the profit from the sales referred to already, the cost of sales and administration and selling expenses were deducted.

You are required to prepare:

(*a*) a Funds Flow Statement showing details of changes in Working Capital.

(*b*) a Cash Flow Statement.

[**Ans.** Funds from Operations Rs 8,20,000; Total Sources of Funds Rs 10,60,000; Total Applications of Funds Rs 4,17,000; Cash Outflow on account of Operations Rs 73,000; Sources of Cash Rs 2,40,000; Applications of Cash Rs 4,90,000]

Schedule of Changes in Working Capital

12. From the following Balance Sheets you are required to prepare schedules of changes in working capital of 1993 and 1994.

Liabilities	*31 Dec. 1992 Rs*	*31 Dec. 1993 Rs*	*31 Dec. 1994 Rs*	*Assets*	*31 Dec. 1992 Rs*	*31 Dec. 1993 Rs*	*31 Dec. 1994 Rs*
Share Capital	40,000	50,000	50,000	Cash	30,000	40,000	45,000
9 per cent				Inventories	10,000	15,000	10,000
Debentures	20,000	20,000	30,000	Accounts			
Sundry Creditors	20,000	20,000	40,000	Receivable	20,000	20,000	25,000
Outstanding				Land	20,000	20,000	30,000
Expenses	10,000	20,000	20,000	Plant	40,000	60,000	70,000
Tax Payable	10,000	15,000	20,000				
Retained Earnings	20,000	30,000	20,000				
	1,20,000	1,55,000	1,80,000		1,20,000	1,55,000	1,80,000

[**Ans.** (*i*) No change in working capital in 1993 as compared to 1992. (*ii*) Decrease in working capital Rs 20,000 in 1994 as compared to 1993]

[**Hint.** Tax payable is a current liability]

NOTES

Funds from Operations

13. Calculate the Funds from Operations from the following Profit and Loss Account:

PROFIT AND LOSS ACCOUNT

Particulars	*Rs*	*Particulars*		*Rs*
To Salaries	5,000	By Gross Profit		50,000
To Rent	3,000	By Profit on sale of buildings		
To Depreciation on plant	5,000	Book value	Rs 10,000	
To Printing and stationery	3,000	Sold for	15,000	5,000
To Preliminary expenses written off	2,000			
To Goodwill written off	3,000			
To Provision for tax	4,000			
To Proposed dividends	6,000			
To Net profit taken to balance sheet	24,000			
	55,000			55,000

[**Ans.** Rs 39,000]

Simple Funds Flow Statement

14. The following are the summarised Balance Sheets of *XYZ* Ltd., as on 31 December, 1996 and 1997:

BALANCE SHEETS

Liabilities	*31 December 1996 Rs*	*31 December 1997 Rs*	*Assets*	*31 December 1996 Rs*	*31 December 1997 Rs*
Capital 14 per cent Redeemable			Fixed Assets:	41,000	40,000
			Less: Depreciation	11,000	15,000
Preference shares	–	10,000		30,000	25,000
Equity shares	40,000	40,000	Current Assets:		
	40,000	50,000	Debtors	20,000	24,000
General Reserve	2,000	2,000	Stock	30,000	35,000
Profit and Loss A/c	1,000	1,200	Prepaid Expenses	300	500
Debentures	6,000	7,000	Cash	1,200	3,500
Current Liabilities:					
Creditors	12,000	11,000			
Provision for Tax	3,000	4,200			
Proposed Dividends	5,000	5,800			
Bank Overdraft	12,500	6,800			
	81,500	88,000		81,500	88,000

You are required to prepare:

(*i*) a statement showing changes in the working capital and

(*ii*) a statement of sources and applications of funds.

[**Ans.** Funds from operations Rs 4,200, Increase in working capital Rs 16,200]

15. From the following particulars, prepare the Funds Flow Statement:

Liabilities	*1 Jan. Rs*	*31 Dec. Rs*	*Assets*	*1 Jan. Rs*	*31 Dec. Rs*
Creditors	36,000	41,000	Cash	4,000	3,600
Bank Loan	30,000	45,000	Debtors	35,000	38,400
Capital	1,48,000	1,49,000	Stock	25,000	22,000
			Land	20,000	30,000
			Building	50,000	55,000
			Machinery	80,000	86,000
	2,14,000	2,35,000		2,14,000	2,35,000

During the year, drawings by the proprietor for personal; use amounted to Rs 26,000 provision for depreciation on machinery stood at Rs 27,000 on 1 January and at Rs 36,000 on 31, December.

[**Ans.** Decrease in Working Capital Rs 5,000]

NOTES

Comprehensive Funds Flow Statement

16. From the Balance Sheets of *A* Ltd., make out:

(*a*) a Statement of Changes in the Working capital. (*b*) a Funds Flow Statement.

BALANCE SHEETS

Liabilities	*31 March 1995 Rs*	*31 March 1996 Rs*	*Assets*	*31 March 1995 Rs*	*31 March 1996 Rs*
Equity Share Capital	3,00,000	4,00,000	Goodwill	1,15,000	90,000
			Land and Buildings	2,00,000	1,70,000
12% Redeemable			Plants	80,000	2,00,000
Preference Share Capital	1,50,000	1,00,000	Debtors	1,60,000	2,00,000
General Reserve	40,000	70,000	Stock	77,000	1,09,000
Profit and Loss A/c	30,000	48,000	Bills Receivable	20,000	30,000
Proposed Dividends	42,000	50,000	Cash in hand	15,000	10,000
Creditors	55,000	83,000	Cash at bank	10,000	8,000
Bills Payable	20,000	16,000			
Prov. for Taxation	40,000	50,000			
	6,77,000	8,17,000		6,77,000	8,17,000

Additional Information:

(*i*) Depreciation of Rs 10,000 and 20,000 has been charged on Plant and Land and Buildings respectively in 1996.

(*ii*) An interim dividend of Rs 20,000 has been paid in 1996.

(*iii*) Income Tax of Rs 35,000 has been paid in 1996.

[**Ans.** Funds from operations Rs 2,18,000, Total sources Rs 3,28,000, Total applications Rs 2,77,000]

[**Hint.** Provision for tax has been taken as a non-current liability.
Presume that last year's dividend must have been paid during the year.]

17. From the following Balance Sheet of a Company you are required to prepare (*i*) a statement showing changes in the working capital and (*ii*) a statement of sources and application of funds.

Liabilities	*Jan.1994 Rs*	*Dec. 1994 Rs*	*Assets*	*Jan.1994 Rs*	*Dec. 1994 Rs*
Current Liabilities	30,000	32,000	Cash	40,000	44,400
Bonds Payable	20,000	20,200	Accounts receivable	10,000	20,700
Capital stock	35,000	43,500	Inventories	15,000	15,000
Retained earnings	15,000	19,500	Land	4,000	4,000
			Building	20,000	16,000
			Equipment	15,000	17,000
			Accumulated depreciation	(5,000)	(2,800)
			Patents	1,000	900
	1,00,000	1,15,200		1,00,000	1,15,200

Additional Information:

(*a*) Income for the period Rs 10,000.

(*b*) A building that cost Rs 4,000 and which had a book value of Rs 1,000 was sold for Rs 1,400.

(*c*) The depreciation charge for the period was Rs 800.

(*d*) There was Rs 5,000 issue of common stock.

(*e*) Cash dividends Rs 2,000 and Rs 3,500 stock dividend were declared.

(*M Com Madurai Nov., 1981, adapted*)

[**Ans.** Increase in Working Capital Rs 13,100. Sources Rs 17,100, Applications Rs 4,000]

NOTES

18. Prepare a Funds Flow Statement from the following data:

	31 Dec. 1993 *Rs*	*31 Dec. 1994* *Rs*
Cash	2,000	2,500
Accounts receivable	2,400	2,700
Inventories	3,100	3,200
Other assets	800	700
Fixed assets	5,000	5,800
Accumulated depreciation	2,100	2,500
Accounts payable	2,000	2,100
Long-term debt	1,400	1,300
Equity capital	5,000	5,300
Retained earnings	2,800	3,700

Notes:

(*a*) Fixed assets costing Rs 1,200 were purchased for cash.

(*b*) Fixed assets (original cost Rs 400, accumulated depreciation Rs 150) were sold for Rs 200.

(*c*) Depreciation for the year 1994 amounted to Rs 550 and duly debited to Profit and Loss Account.

(*d*) Dividends paid amounted to Rs 300 in 1994.

(*e*) Reported income for 1994 was Rs 1,200.
(*M Com, Madras, December 1979*)

[**Ans.** Increase in Working Capital Rs 700, Sources Rs 2,300, Applications Rs 1,600]

19. The balance sheet of Work Well Private Ltd., as on 31 March 1996 and 31 March 1997 are as given below:

Liabilities	*1996* *Rs*	*1997* *Rs*	*Assets*	*1996* *Rs*	*1997* *Rs*
Issued Share Capital			Freehold Properties at	20,000	16,000
(shares of Re 1 each)	3,00,000	3,50,000	Plant and Machinery at		
Capital Reserves:			at cost (*less*: depreciation)	2,86,000	3,08,000
Share Premium	–	10,000	Current Assets	1,38,400	1,66,100
Profit on sale of			Preliminary Expenses	1,600	800
freehold land	–	2,900			
Profit and loss A/c	32,000	60,000			
15 per cent Debentures	50,000	–			
Current Liabilities	64,000	68,000			
	4,46,000	4,90,900		4,46,000	4,90,900

The whole of the share capital of the company was issued for cash. Depreciation on plant and machinery written off during the year to 31 March, 1997 amounted to Rs 28,000. During the same year the company paid a dividend of Rs 15,000.

Prepare a statement showing: (*i*) the net increase in working capital during the year ended 31 March, 1997 and (*ii*) the sources and applications of funds during the year.

[**Ans.** Increase in Working Capital Rs 23,700, Sources Rs 1,38,700, Applications Rs 1,15,000]

20. The following are the summarised financial statements of Madras Electronics Ltd.

BALANCE SHEET (*Rs in thousands*)

Liabilities	*31 December* *1994*	*1995*	*Assets*	*31 December* *1994*	*1995*
Equity Share Capital	1,000	1,000	Fixed Assets	4,000	4,500
Debentures	2,000	2,000	(*Less*: Depreciation)		
Retained Earnings	1,500	2,000	Inventory	1,250	1,500
Sundry Creditors	900	1,000	Accounts Receivable	650	550
Bills Payable	400	500	Cash	400	500
Outstanding Wages	200	300			
Accrued Taxes	300	200			
	6,300	7,000		6,300	7,000

INCOME STATEMENT FOR 1995

(Rs in thousands)

Sales		10,000
Cost of goods sold	5,000	
Administration and selling expenses	1,500	
Depreciation	300	
Interest	200	7,000
Net Income before Taxes		3,000
Taxes		1,500
Net Income after Taxes		1,500

NOTES

Prepare for the year ended 31 December, 1995:

(*a*) A statement of Sources and Applications of Funds;

(*b*) A statement showing the Changes in Working Capital.

[**Ans.** No change in Working Capital position]

[**Hint.** Provision for taxation has been taken as a current liability]

21. From the following balance sheets and additional information relating to Precision Tools Ltd., prepare:

(*i*) Statement showing the Changes in the Working Capital, and

(*ii*) Statement of Sources and Applications of Funds for the year ended 31 December, 1996:

BALANCE SHEET (*Rs in thousands*)

Liabilities	*31 December 1995*	*31 December 1996*	*Assets*	*31 December 1995*	*31 December 1996*
Sundry Creditors	1,000	1,030	Cash	1,600	1,776
Bills Payable	200	250	Sundry Debtors	400	740
Debentures	880	880	Stock of Raw materials	220	248
Depreciation Fund	200	112	Stock of Finished Goods	280	240
Reserves and Surplus	600	780	Stock of Work-in-progress	100	200
Share Capital	1,400	1,740	Land	160	160
			Buildings	800	640
			Plant and Machinery	600	680
			Debenture Discount	80	72
			Patents	40	36
	4,280	4,792		4,280	4,792

Additional Information:

(*a*) Net Profit reported Rs 4,00,000

(*b*) Dividend paid 80,000

(*c*) Depreciation charged to profits 32,000

(*d*) The company issued equity shares of Rs 2,00,000 and bonus shares for Rs 1,40,000.

(*e*) A building was sold off for Rs 56,000 the cost and book value being Rs 1,60,000 and Rs 40,000 respectively.

[**Ans.** Increase in Working Capital Rs 5,24,000, Funds from operations Rs 4,28,000]

22. The following are the summarised trial balances of Honesty Ltd., as on 31 December, 1996 and 31 December, 1997.

Particulars	*31 December 1996*		*31 December 1997*	
	Dr.	*Cr.*	*Dr.*	*Cr.*
Issued share capital		8,00,000		8,00,000
Capital reserve				2,00,000
8 per cent debentures				2,50,000
Discount on issue of debentures			5,000	
Land and building	5,00,000		4,00,000	
Plant and machinery	10,00,000		12,50,000	
Provision for depreciation on fixed assets		4,00,000		5,00,000
Profit and loss A/c:				
Balance on 1st January		3,00,000		4,50,000

Contd...

NOTES

Net profit for the year		2,30,000		3,00,000
Dividend for the previous year	80,000		80,000	
Provision for doubtful debts		20,000		35,000
Trade investments (at cost)	1,00,000		3,00,000	
Current Assets	7,00,000		8,50,000	
Current Liabilities		3,50,000		2,50,000
Bank Overdraft		2,80,000		1,00,000
	23,80,000	23,80,000	28,85,000	28,85,000

Additional Information:

(1) During the year, Land and Building having an original cost of Rs 1,00,000 and a written down value of Rs 75,000 have been sold for Rs 3,00,000. The capital profit has been transferred to Capital Reserve and the profit equivalent to the depreciation written off in the past has been included in the profit for the year.

(2) On 1 January, 1997 the company issued debentures of a face value of Rs 2,50,000 at a discount of 5 per cent. Part of the discount has been written off out of the profits.

Prepare a statement of sources and applications of funds during the year.

[**Ans.** Increase in Working Capital Rs 4,15,000, Funds from Operations Rs 4,07,500]

23. The summarised balance sheets of *XYZ* Ltd., as on 31 December 1994 and 31 December, 1995 are given below:

Liabilities	*1994* *Rs*	*1995* *Rs*	*Assets*	*1994* *Rs*	*1995* *Rs*
Share Capital	4,50,000	4,50,000	Fixed Assets	4,00,000	3,20,000
General Reserve	3,00,000	3,10,000	Investments	50,000	60,000
P. & L. A/c	56,000	68,000	Stocks	2,40,000	2,10,000
Creditors	1,68,000	1,34,000	Debtors	2,10,000	4,55,000
Provision for Taxation	75,000	10,000	Bank	1,49,000	1,97,000
Mortgage Loan	–	2,70,000			
	10,49,000	12,42,000		10,49,000	12,42,000

Additional information:

(*i*) Investments costing Rs 8,000 were sold during the year 1995 for Rs 8,500.

(*ii*) Provision for tax made during the year was Rs 9,000.

(*iii*) During the year part of the fixed assets costing Rs 10,000 were sold for Rs 12,000 and the profit was included in profit and loss account; and

(*iv*) Dividend paid during the year amounted to Rs 40,000.

You are required to prepare a statement of sources and uses of funds.

(*Adapted from CS Final, June 1981*)

[**Ans.** Total sources Rs 4,29,000, Applications Rs 1,32,000, Funds from operation Rs 1,38,500]

[**Hint.** Provision for tax presumed to be non-current liability]

24. The following are the summaries of the balance sheets of a limited company as on 31st December, 1994 and 31st December 1995:

Liabilities	*1994* *Rs*	*1995* *Rs*	*Assets*	*1994* *Rs*	*1995* *Rs*
Sundry Creditors	39,000	41,000	Cash at Bank	2,500	2,700
Bills Payable	34,280	11,660	Sundry Debtors	87,490	73,360
Bank Overdraft	59,510	–	Stock	1,11,000	97,300
Provision for Taxation	40,000	50,000	Land and Buildings	1,48,500	1,44,250
Reserves	45,000	45,000	Plant and Machinery	1,12,990	1,36,270
Profit and Loss A/c	44,690	46,220			
Share Capital	2,00,000	2,60,000			
	4,62,480	4,53,880		4,62,480	4,53,880

The following additional information is obtained from the general ledger:

(*i*) During the year ended 31st December, 1995 an interim dividend of Rs 26,000 was paid.

(*ii*) The assets of another company were purchased for Rs 60,000 payable in fully paid shares of the company. These assets consisted of stock Rs 21,640 and machinery Rs 38,360. In addition, sundry purchase of plant were made totalling Rs 5650.

(*iii*) Income-tax paid during the year amounted to Rs 25,000.

(*iv*) The net profit for the year before tax was Rs 62,530.

Prepare a statement showing the sources and applications of funds for the year 1995 and a schedule setting out changes in working capital. (*CS Inter, June 1992, adapted*)

[**Ans.** Funds from Operations Rs 87,510, Increase in Working Capital Rs 52,500, Sources 1,09,150, Applications Rs 56,650]

NOTES

7.22 FURTHER READING

1. Maheshwari, S.N. and S.K. Maheshwari, *An Introduction to Accountancy*.
2. Maheshwari, S.N. and S.K. Maheshwari, *A Text Book for Accounting for Management*.

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