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NEED OF FUND FLOW STATEMENT: A CONCEPTUAL STUDY

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ABSTRACT:-

Fund flow statement is a statement which shows the sources from which funds are obtained and uses to which fund are put. By fund are generally mean working capital. Thus, fund flow statement is a technical device to explain how the working capital position of an enterprise changes over a period of time generally covering two balance sheet dates. It reveals the amount of fund generated by the firm internally along with the amount of funds raised from various external sources and their various uses during the year. This paper is a modest attempt to study the conceptual Framework of Fund Flow Statement.

KEYWORDS: *Fund Flow Statement, Sources of Fund, Uses of Fund.*

INTRODUCTION :

At the end of each accounting period, preparation and presentation of financial statements are undertaken with an objective of providing as much information as possible for the public. The balance sheet presents a snapshot picture of the financial position at a given point of time and the income statement shows a summary of revenues and expenses during the accounting period. Though these are significant statements especially in terms of the principal goals of the enterprise, yet there is a need for one more statement which will indicate the changes and movement of funds between two balance sheet dates which are not clearly mirrored in the balance sheet and income statement. That statement is called as funds flow statement. The analysis which studies the flow and movement of funds is called as funds flow analysis.

It is one of the critical indicators that shows how funds are used. Finance analysts will be able to evaluate the fund flow of an organisation in due course under this statement. It is also known as the application of the Funds and the Statement of Sources, as this statement describes the movement of funds between different sources and their applications.

The preparation of these statements usually follows an analysis of the flows of funds. As a financial instrument, it helps companies manage their finances and better account for the use of funds.

CONCEPT OF FUNDS

How are funds defined? Perhaps the most ambiguous aspect of funds flow statement understands what is meant by funds. Unfortunately there is no general agreement as to precisely how funds should be defined. To a lay man the concept of funds means `cash‟. According to a few, `funds‟ means `net current monetary assets‟ arrived at by considering current assets (cash + marketable securities + short term receivables) minus short term obligations. A third view, which is the most acceptable one, is that concept of funds means `working capital‟ and in this lesson the term `funds‟ is used in the sense of Working capital.

WORKING CAPITAL CONCEPT OF FUNDS

The excess of an enterprises total current assets over its total current liabilities at some point of time may be termed as its net current assets or working capital. Any increase in total current assets or any decrease in total current liabilities will result in a change in working capital.

Flow of Funds

The term `flow‟ means change and therefore, the term `flow of funds‟ means `change in funds‟ or `change in working capital‟. According to manmohan and goyal, "the flow of funds" refers. To movement of funds described in terms of the flow in and out of the working capital area. In short, any increase or decrease in working capital means `flow of funds‟. Many transactions which take place in a business enterprise may increase its working capital, may decrease it or may not affect any change in it.

Sources of Funds

Sources of funds include cash farm receipts, capital asset sales, increases in liabilities, outside equity capital infused into the business, and net non-farm cash income. The increase in total liabilities is derived from the beginning and ending balance sheets. It is particularly important to track the change in total liabilities from the beginning to the end of the year. If a farm borrows more money than its reduction in short-term and long-term debt (i.e., principal payments), we have a source of funds. Conversely, if a farm pays back more debt than it borrows, we have a use of funds.

Uses of Funds

Uses of funds include farm cash operating expenses, capital asset purchases, decreases in total liabilities, equity capital withdrawals, family living withdrawals, and income and self-employment taxes. A farm that is expanding will typically have a larger amount of capital purchases than capital sales so capital assets are generally a use of funds rather than a source of funds. A farm that is expanding would probably also have an increase in total liabilities rather than a decrease in total liabilities. In contrast, a farm that is downsizing, perhaps in anticipation of future retirement, would typically have relatively higher asset sales compared to asset purchases, and may exhibit a decrease in total liabilities as loans are paid back.

Importance of Funds Flow Statement

1. To Explain the Changes in Financial Position: The objective of funds flow statement is to disclose the cause of changes in the assets, liabilities and equity capital between two balance sheet dates. It highlights the changes in financial position of a concern and indicates the various means by which funds were obtained during a particular and the ways to where these funds were utilized.
2. To Analyze the Operational Position: Another objective of found flow statement is to analyze the operational position of a concern. Balance sheet gives a static view of the financial position and the profit and loss reported by income statement cannot tell about the actual liquidate position of a firm. Sometimes a firm with high profit may not be able to pay its immediate liabilities due to the shortage of cash. But the objective of funds statement is to explain both the causes of various in different assets, liabilities and capital accounts and their effect on the liquidity position of the concern.
3. To Help in Proper Allocation of Resources: The objective of funds flow statement is to provide information regarding the allocation of limited resources with more efficiently and effectively. It provides the information about the internal and external sources of financing furthermore. It

provides data regarding the unbalance fund. On the basis of such information a concern can allocate its funds in and long-term areas more properly.

4. To Evaluate Financial Position: Internal and external users of financial statements require funds flow statement for the purpose of assessing the strengths and weakness of the concerned firm. Funds flows statement provides information regarding the changes in net information enable various groups of users to assets and evaluates the financial position of the firm.
5. To Act as Future Guide: Funds flow statement acts as a guide for future to management. Funds flow statement provides information about the historical changes in net assets and capital which enable the management to develop a projected funds flow statement. Such projected funds flow statement helps to product need for found and alternative sources of financing.

LIMITATION OF FUNDS FLOW STATEMENT

Funds flow statement is a major tool of financial analysis, however, it as the following limitations:

1. Ignores the Non-Fund Transactions: Fund flow statement ignores the non-fund transactions i.e. it does not take into consideration those transactions which do not affect the working capital. For example, funds flow statement does not record the purchase of fixed assets by the issue of share or debentures.

2. Based on Secondary Information: Funds flow statement is based on secondary data. In other words, funds flow statement is based on income statement and balance sheet.

3. Historical in Nature: Funds flow statement is historical in nature because it is prepared on the basis of historical financial statement i.e. balance sheet and income statement.

How to Prepare a Fund Flow Statement?

An organisation must take several steps to prepare a financial flow statement, as mentioned below.

Step 1

A schedule of working capital changes will be created. Consider how the current liabilities and existing assets have changed over time. In addition, note that the difference between current assets and liabilities determines net working capital change.

Step 2

To determine the Funds from Operations, you should prepare an adjusted P&L account. This relates to the amounts a company spends and earns in its regular business course rather than investment or financing activities. Several adjustments to the corporation's annual profit are made. They add noncash costs such as amortisation and depreciation. After the deduction of any gain on the sale of investments and fixed assets, the actual funds generated from operating activities will also be calculated.

Step 3

You must specify inflows and outflows to create a flow statement on the fund. The balance sheet should also be used to determine the source of funds or directional growth or contraction of its use to generate a fund flow statement. Any net change in working capital or funds from operations will also be included when the information is completed.

CONCLUSION

With the aid of a fund flow statement structure, it is possible to draw up a fund flow statement. The company shall make a statement to assess how working capital has evolved between the two balance sheets. It provides support to management in making decisions for the future. However, since it only considers funding items, management cannot rely solely on a financial flow statement for all decisions.

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