

FUNDS FLOW STATEMENTS—NATURE, TECHNIQUES AND MANAGERIAL USES

FINANCIAL reporting by the Corporations acquires significance only when it enables analysis and interpretation to suit the requirements of divergent groups. Traditionally, the reporting is conveyed through the annual reports which contain *inter alia* the Balance Sheet and Income Statement. At one time Balance Sheet was recognised as the basis of financial reporting and the financial statistics it provides was considered useful for all purposes. The trend in accounting has, however, brought shift in general thinking and the emphasis is on the 'progressive measurement' rather than 'static measurement' of financial position and this has made income statement a major plank of financial reporting. This again has adversely affected the meaningful asset valuation and, of late, there is a widespread feeling to consider this aspect too. It implies the preparation of 'funds flow statements' and now 'funds statements', especially in U.S.A, are appearing increasingly in published company reports and hence greater attention to asset valuation should result "Income measurement will LIFO inventory costs could ignore, as it were, the consequences for position statement inventory valuations. But funds statements articulate more closely with *both* income and position statements, and must be responsive to the meaningful criteria each requires, if realistic."¹ A reference to the accounting literatures reveals that funds statements were first seen in 1890's and at that time Balance Sheet was regarded as a principal financial statement. After more than half a century of slow development and scant recognition, analysis of funds flow came into prominence in the early 1960's.² In this article we have endeavoured to outline the nature of the term 'funds', the techniques of preparing the funds statements with modern refinements, called 'Assignability approach' and its managerial uses. An attempt has also been

made to study the possibility of marging income statement with the statement of funds.

II

MEANING OF THE TERM 'FUNDS'

✓ A 'funds flow statement' also called 'uses and sources of funds' or 'Funds received and disbursed' or 'Where got and gone statements' etc., is a condensed report of how activities of business have been financed and financial resources have been used during the period covered by the statement. } A funds statement is shown in the summary form to indicate changes (and trends, if prepared regularly) occurring in the items of financial condition between two different balance sheet dates. ✓ "In a statement of sources and funds only the net changes are shown so that the outcome of the transaction or of a series of transactions upon the financial conditions of a business enterprise is reflected in a more striking manner."³ ✓

✓ The term 'funds' must be understood at the outset since a lot of confusion persists regarding its meaning. ✓ Some would interpret it to mean cash; others as purchasing power. From the latter point of view buying on credit is as much an exercise of purchasing power as in the expenditure of cash. This is true since funds are economic values expressed in money measurements which are subject to firm's jurisdiction. "Often the term funds is interpreted to mean the net period effect upon the working capital position of the business and the statement of sources and applications of funds is so designed as to emphasize this effect. } Actually however the flow of funds into and out of business working capital, while a most important experience, is but one of the applications and sources requiring consideration. Other experiences are also important. It is the total ebb and flow effect which needs to be depicted."⁴ Thus the term 'funds' has been given several meanings ranging from mere cash to working capital and even more. This is also substantiated from an opinion dealing with the statement of Sources and Application of Funds published in October 1963 by the Accounting Principles Board of the American Institutes. The following is quoted from its introduction:

"Accountants have long prepared statements of sources and

application of funds for management... The concept of funds used in these statements has varied somewhat in practice, and variations in the concept have resulted in variations in the nature of the statements. For example 'funds' has sometimes been interpreted to mean cash or its equivalent; in such cases the resulting statement of sources and application of funds is a statement of cash receipts and disbursements. [The most common concept of "funds" has, however, been that of working capital *i.e.*, current assets less current liabilities. If the definition is applied literally, the resulting statement includes only those transactions which affect the current assets of current liabilities. A broader interpretation identifies "funds" as all financial resources arising from transactions with parties external. To the business enterprise."5

We have adopted a broader approach which conceives all financial resources as funds. Broader concept includes those items too which do not affect the working capital accounts, for example, purchase of plant in exchange for shares. The broader approach provides complete and informative presentation.

III

SOURCES AND APPLICATIONS OF FUNDS

The complete picture of a business supported by relevant information is obtained only when an attempt is made to analyse both the financial statements, namely, Balance Sheet and Income Statement. In addition a scrutiny of the supplementary data is also essential. Such lengthy process is shortened and interpretation facilitated since "the funds statement summarises the over-all investment and financing activities of a company. It shows the principal sources and application of funds."6 Its major items are grouped under two broad headings :

- (1) Sources of Funds, and
- (2) Applications of Funds

SOURCES OF FUNDS

In any enterprise the sources of funds are :

- (a) Operations or Net Profit
- (b) Increases in Liabilities ✓
- (c) Decreases in Assets ✓
- (d) Issuance of Long-term debt or Capital stock.

Operations or Net Profit. ✓ The net profit or income of an enterprise indicates the excess of sale proceeds over the operating expenses and it is an important and regular source of funds. This becomes evident from the increase in assets or decrease in liabilities to the extent of net profit or income. "In other words, the net profits are reflected in an increase of the earned surplus account; a corresponding reduction must take place in the liabilities, or a partial change must take place in both assets and liabilities." ✓ It may be clarified that the amount of sales cannot be treated as the "funds" since if whole cash is not spent on expenses, funds must find place in other assets. Since it is not so, the amount incurred on expenditure must be deducted from the net sales.

✓ Furthermore, it will be noted that 'Income statement' contains certain items which reduce the net profit without affecting the "funds". Such items include the depreciation and amortization of fixed assets, ✓ amortization of long term deferred charges and other non cash charges. In order to obtain the total amount of funds from operations, these charges must be added back to the net profit or income figure. ✓ 'Revenue is thereby depicted as returning to the business funds paid out to acquire assets in earlier periods, or as providing the business with funds to cover amounts which did not originally require the expenditure of funds'. ✓ Finally, if there is net loss, the amount of loss is shown as an application of funds. ✓

Increase in Liabilities. Business transactions consist of cash as well as credit dealings and increase in liabilities indicate the purchase of goods on credit, accrued expenses etc. This implies the use of the borrowed funds. Long or short term borrowings increase cash funds and if the same are invested, the increase in assets becomes the application of funds.

Decrease in Assets. It is a common feature of almost every

business that a decrease in some asset is matched by an increase in some other asset, e.g., the sale of inventories for cash would reduce the inventory figure and increase cash funds with the result that the source of funds is the reduction in investment account and the application of funds would be the increase in cash.

Issuance of Long-term debt or capital stock. This is not a frequent source of funds as the 'contribution' is not a everyday occurrence. And in case the funds are contributed they are usually in the form of cash but often in some other asset or assets too.

APPLICATION OF FUNDS

Receipt of funds from the four sources mentioned above will ultimately lead to their applications for different uses which may be as under :-

- (a) Net Losses
- (b) Decrease in Liabilities
- (c) An increase in Assets—current, fixed, intangible assets etc.
- (d) A decrease in capital funds.

Net Losses. Funds are obtained from the operations when the amount of sale exceeds the amount spent as expenses. On the same principles, if the income statement reveals a loss, it is an application of funds, and funds are assumed to have gone out of the business.

✓ "A net loss must be offset either by a decrease in assets or an increase in liabilities, either or both of which would be the source of funds to provide for this particular application."²⁸

Decrease in Liabilities. Funds would obviously be taken out of an enterprise to pay off the liabilities—current, fixed or both. For instance if the bills payables of Rs. 10,000 are paid off, there will be a shrinkage in cash. It is, however, not necessary to find a change in the cash balance since the funds might have been obtained :

- (i) by collecting bills, receivables or selling investments;
- (ii) by allowing the creditors to continue and the cash funds normally used to discharge the creditors being used to pay off the bills payable;

- (iii) the net profits might be enough to provide cash.
- (iv) a combination of various sources mentioned in (a), (b) and (c).

Increase in Assets : Funds should be needed when assets such as inventories, receivables, investments etc., are increased and funds must come from one or several sources. If an asset is purchased for Rs. 10,000 and Rs. 1,000 is paid cash and Rs. 9,000 as mortgage, the sources of funds would be Rs. 1,000 from its own cash, the other Rs. 9,000 from the increase in liabilities.

Decrease in Capital Funds. The situation of this type arises when the proprietors withdraw a part of their capital and in the case of Corporation it takes the form of dividend disbursement. Retirement of stock may, however, also decrease the capital funds.

It is obvious that each use or application of funds, as an investment decision, must be off-set by one or more sources of funds, since one cannot invest, what one does not have available. Thus a new plant can be bought by reducing cash balance and partly by increasing the debt. Similarly, a given source must have off-setting uses. Funds raised from the issue of shares may be committed to increases in cash, inventory or machinery or reductions in liability.

IV

PREPARING THE FUNDS FLOW STATEMENT—SOME PRELIMINARIES

The techniques used in the preparation of funds flow statement vary from company to company. But the basic information, however has to be obtained and it comes from the following sources :

- (a) Two Comparative Balance Sheets with an accompanying increase-decrease columns.
- (b) The Income Statement for the accounting period.
- (c) Supplementary schedules for additional data.

COMPARATIVE BALANCE SHEETS

Balance sheets will contain the figures of assets and liabilities of

the previous year with additional columns recording the increase or decrease over the previous year. A balance sheet shows three sources of funds, namely, an increase in liabilities, a decrease in assets and decrease in net worth; the last use again implies two things—net losses and decrease in capital funds.

THE INCOME STATEMENT

This is also an essential document to prepare the funds statement, although in its absence 'the net worth' is used for net profit or loss, as the case may be. As Foulke puts it :

“To formulate a complete statement of sources and application of funds not only comparative balance sheets but also one or more income statements are essential. If the two balance sheets represent the condition of a concern or consecutive fiscal dates, then the income statement for the last fiscal year, ending on the same date as the last balance sheet, is necessary. If the comparative balance sheets cover a period of several years, it is necessary to have all the intervening fiscal income statements to obtain the exact amount of net profits and non-cash expenses for the full period.”⁹

Income statement must be suitably adjusted in the following manner in order to arrive at the total sources or application of funds from the operations.

(i) *Depreciation on fixed assets.* The amount charged as depreciation reduces the amount of fixed assets without affecting the working capital and, therefore, the amount of depreciation should not be deducted from the income while calculating the funds from operations. And, if deducted, it must be added back.

It is often stated that the funds are obtained from the depreciation allowances or depreciation charges or depreciation reserves. [This misconception must be cleared, for, funds are generated by sales. Charging more or less depreciation does not effect the working capital and it only affects the income and the amount has to be added back to complete the amount of funds from operations.]

(ii) *Loss or Gain on sale of Non-current Assets :* Fixed assets

(Land, Building or Equipment) and investments are two most common types of long lived asset as which may be sold. Any loss or gain on their sales must be eliminated to get the true figure of funds. The simple procedure is to add the loss to income (since it has been subtracted) and deduct the gain (since it has been added) 'Any current assets received from the sale of long lived assets are, of course, included and described in the funds statement. To include the gain also would be a double counting.'

SUPPLEMENTARY SCHEDULES FOR ADDITIONAL DATA

In addition to the comparative balance sheets and corresponding income statements for presenting sources and applications of funds, supplementary data are also imperative for adjustments. For instance, the company might have sold an asset on which certain depreciation was already provided; the additional information will facilitate to determine the cost of the asset as also the source and application of funds. Attention must be directed to the following adjustments :

- (a) Provision against current assets
- (b) Sale of Fixed assets
- (c) Dividends paid
- (d) Appreciation in the value of assets.

Provision against current assets ✓ Provision for bad debts, discounts and for loss of stock are most common and any increase or decrease in these affects working capital. It is contended that they must be added or subtracted, as the case may be, and shown as the funds provided. This, of course, is objectionable in so far as it distorts or rather throws out, the true increase or decrease of working capital.

Two alternatives are suggested to overcome the difficulty :

- (i) The provision at the beginning and at the end respectively is deducted from the debtors on these dates and the net change is then shown as a change in working capital.
- (ii) Both the provisions and debtors may be shown at their gross

figures in their respective liabilities and assets sides and the effect of changes would be the same as in (i)

Sale of Fixed assets: No difficulty is encountered on the sale for cash of any current asset since such reduction is shown as a decrease in the working capital in the statement of funds.

It may, however, happen in the case of some fixed asset, say, plant, that there is movement in terms of sale or purchase of such items. Cash received on the sale may be either shown as funds provided or a subtraction from additions to the plant appearing under funds applied. If the sales are larger than additions, then such an item can be safely placed as a separate figure under funds provided.

Particular care should be exercised regarding investments in shares, bonds etc., and the purpose for which they are held is of paramount significance to decide whether or not they are current or fixed assets. Nothing should be reflected in the statement of funds when the amount involved is the same on the exchange of shares for bonds or debentures.

Dividends Paid: The declaration of dividends is an item of appropriation and this fact need not be mentioned in the statement of funds. And upon payment, of course, it is an application of funds. Unpaid dividends shown in the Balance Sheet, though not affecting the funds statement, should be shown as a footnote since the absence of such an important item from the statement may not be understood by those who use it.

'Of course, if, as is becoming the custom, a prepaid dividend is provided for in the accounts, then, this will be included in working capital as it is recommended that it is contained in the current liabilities.'

Appreciation of Assets: Such an increase in assets is not considered profits from trading and thus not shown as a source or application of funds. If it is desired to show in the fund statement, it must be done by means of a footnote. The raising of goodwill otherwise than purchase comes into this category.

V

A stage is now set to depict the actual presentation of the funds statement by incorporating the facets of theoretical framework.

A TYPICAL ILLUSTRATION

BALANCE SHEETS.....of ABC Co.

	1967 [31-12-]		1968 [31-12-]	
	Rs.	Rs.	Rs.	Rs.
<i>Current Liabilities</i>				
Creditors	7,800		8,332	
Bills Payable	6,758		2,200	
Bank Overdraft	12,000		—	
Provision for Tax	8,000	34,558	10,000	20,532
<i>Share Holder's Equity</i>				
Paid-up Capital	44,000		54,000	
Reserve	6,000		8,000	
Appropriation A/c	7,938	57,938	8,244	70,244
Total Liabilities		92,496 ✓		90,776
<i>Current Assets</i>				
Cash	300		2,200	
Debtors	17,232		13,886	
Stock	22,000		18,400	
Pre Payments	674	40,206	200	34,686
<i>Fixed Assets</i>				
Property	29,700		28,850	
Plant	22,590	52,290	25,240	54,090
Goodwill		—		2,000
Total Assets		92,496		90,776

ADDITIONAL INFORMATION

During the year, a dividend of Rs. 5,200 was paid and the asst of another Co. were bought for Rs. 10,000 payable in fully paid shares. These assets consisted of :—

Current Asset
 ↙ Stock
 ↘ Machinery
 ↘ Goodwill

Rs.

4,328

3,672 ✓

2,000 ✓

 10,000/-

In addition sundry purchases of plant were made of Rs. 1,130.
Depreciation written off :—

Property	Rs. 850
Plant	Rs. 2,152

Income tax paid during the year Rs. 5,754 was charged to provision for taxation. The net profit before tax was Rs. 15,260.

FUND STATEMENT WORK-SHEET

	1967	1968	Working Capital		Other charges	
			Increase	Decrease	Dr.	Cr.
Current Liabilities						
	Rs.	Rs.	Rs.	Rs.		
Creditors	7,800	8,332		532		
Bills Payable	6,758	2,200	4,558			
Bank O/Draft	12,000	—	12,000			
Provision for Tax	8,000	10,000		2,000		
Share Holder's Equity						
Paid-up Capital	44,000	54,000				10,000
Reserve	6,000	8,000				2,000
Appropriation	7,938	8,244				306
	<u>92,496</u>	<u>90,776</u>				
Current Assets						
Cash	300	2,200	1,900			
Debtors	17,232	13,886		3,346		
Stock	22,000	18,400		3,600		
Pre-payments	674	200		474		
Fixed Assets						
Property	29,700	28,850				850
Plant	22,590	25,240			2,650	
Goodwill	—	2,000			2,000	
Increase in Working Capital				8,506	8,506	
			<u>18,458</u>	<u>18,458</u>	<u>13,156</u>	<u>13,156</u>

STATEMENT OF FUNDS for the year.....

Funds Provided by			
Profit from Trading	15,260		
Add back depreciation :			
[850 + 2,152]	3,002	18,262	
Increase in capital		10,000	
Total Funds Provided			28,262

Funds Applied to

	Rs.	Rs.	Rs.	Rs.
Purchase of Machinery		4,802 ✓		
Purchase of Goodwill		2,000 ✓	6,802	
Purchase of Stock	8,506			
	4,328	4,328		
	<hr/>			
	4,178			
Increase in Costing Capital		4,178	8,506	
Dividend		5,200		
Taxation		7,754	12,954	
[8000—(10000+5754)]				
Total Funds Applied				<hr/> 28,262 <hr/>

CHANGES IN WORKING CAPITAL

	1967	1968	Increase	Decrease
<i>Current Assets</i>	Rs.	Rs.	Rs.	Rs.
Cash	300	2,200	1,900	—
Debtors	17,232	13,886	—	3,346
Stock	22,000	18,400	—	3,600
Pre-payment	674	200	—	474
	<hr/>	<hr/>		
	40,206	34,686		
	<hr/>	<hr/>		
<i>Current Liabilities</i>				
Creditors	7,800	8,332	—	532
Bills Payable	6,758	2,200	4,558	
Bank O/Draft	12,000	—	12,000	
Provision for Tax	8,000	10,000		2,000
	<hr/>	<hr/>		
	34,558	20,532		
	<hr/>	<hr/>		
Working Cap. (Cap. Assets—Cap. Liabilities)	5,648	14,154		8,506
			<hr/>	<hr/>
Net increase in working capital [8506]			18,458	18,458 ✓

NOTES

Since transfer to Reserve of Rs. 2,000/- does not represent cash, we have omitted it from Fund Statement.

Increase in working capital of Rs 8,506 has been shown in two-parts—because it is desirable to show the special purchase of stock [4,328] separately.

REFINEMENTS

1. *Profit and Dividends*: One of the most important source of funds is the net profit. Profits are the first sources, to which management turns for his investment or repayments of obligations.

Use of earnings by way of payment of dividends should be shown separately. Figures for detailed depiction for this are available from Income Statement.

<i>see below</i>	(in lakhs rupees)	
	1967	1968
<i>Sales</i>	3438·6	3598·0
Cost of Sales	2339·4	2530·3
Gen. & Selling Expenses	166·8	172·3
Pensions etc.	33·3	104·4
Taxes (other than I. Tax)	118·8	132·4
Depreciation etc.	204·8	189·8
	2863·1	3129·7
<i>Operating Profits</i>	575·5	468·3
Other Incomes	33·5	45
	609·0	503·3
Total Income	609·0	503·3
Interest etc.	11·5	17·6
	597·5	495·7
Earning before tax	597·5	495·7
Provision for tax	296·0	241·2
	301·5	254·5
<i>Net Profit</i>		
Preference Dividend	25·2	25·2
Equity Dividend	161·4	161·8
	114·9	67·5
<i>Retained Earnings</i>		
Source — Net Profit	254·5	
Use — Dividend	187·0	
Net Source		67·5

DEPRECIATION AS A SOURCE

The total of after tax profits and depreciation is commonly called

as 'Cash-Flow', "Internally generated funds" or "Cash-throw-off". It is useful to show depreciation as a source of fund because the presence of depreciation conceals the full flow of funds.

E.G.	Rs.	Rs.	Rs.	Rs.
Sales			1200	
Cost			1050	
Depereciation			150	
Net Profit			Nil	
<i>In Balance Sheet</i>				
Cash		Beg.	End	Change
Inventory		100	250	+150
Gross Plant	1000	500	500	
Accumulated Dep.	200		350	
Net Plant		800	650	-150
Total Assets		1400	1400	0

Apparently, no profit has been made, yet there is an increase in the Cash of Rs. 150, which of course is off-set by an increase in accumulated depreciation of Rs. 150.

Some-analysts, in an effort to obtain a *CLEAN FUNDS-FLOW STATEMENT* will likewise add back, the 'Non-cash-charges' e.g., amortization of patents against income. It will be added in increase to show a *Source* and in the assets to show a *Use*.

An important decision which must be made prior to the funds flow analysis, is the choice of period to be covered. However, F.F. analysis can be made for shorter periods to show the seasonal swings.

MODERN PRESENTATION

No doubt the usual method of presentation does serve some of the important purposes of management, yet, it lacks in one or two respects. It does not accord an opportunity or scope, to match sources against individual uses and *vice versa*. Hence the need was felt for an 'All-inclusive-statement' which should be:

1. of such firms and content to be of maximum use to management and other parties
2. able to show the effect of management policies and decisions,

GUIDE LINES

(i) The changes are to be expressed in terms of the very categories appearing on comparative balance-sheets, in the beginning and at the end. *The Change in one category is to be related to change in other, i.e. matching of sources of funds with their application.*

(ii) Where an item is part of a category, and the change in that item is to be accounted for, it should be done by means of supporting schedule.

(iii) Changes in a balance sheet category, are to be shown broad, to give proper effect.

(iv) The effect of one balance sheet category on another is established :

(a) through direct assignment—based on events—and management action—available from the minutes of ruling
(Hence, it can be as such used by internal men and not by outside)

(b) Through imputation, based on logic, as per circumstances—imputed as residuals remaining after direct assignment.

Direct assignment and imputation are to be guided by the substance of the situation. *e.g.* Machinery is bought with Cash, and after few days a long term debt is arranged for replenishing cash. We would conclude that machinery is bought with the help of debt.

ILLUSTRATION

1. Long term investment were sold for Rs. 8,000 and used in buying investment of Rs. 8,500, Rs. 500 are taken out of working capital without management decision as to source.

2. Sale of equipment for Rs. 1,000, was incident to the purchase of new equipment for Rs. 10,000.

3. Depreciation of equipment was Rs. 3,750, and was considered in taking the decision regarding the type and amount of new equipment

4. Bonds of Rs. 20,000 were sold for Rs. 17,000 proceeds was used to replanish cash 6,000 applied towards redemption of bonds, 5,250 for purchase of equipment, working capital.

5. Capital stock was sold to finance larger receivables and inventories due to rise in sales volume. . . .

6. Profit for the period 15,000

APPLICATION*

Source	Amount	Purchase of Invest- ment	Purchase of Equip- ment	Redemption of Bonds	Payment of Divi- dend	Working Cap Increase
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Sale of long term debts	8,000	8,000				
Sale of Equipment	1,000		1,000			
Depreciation	3,750		3,750			
Amortization of lease hold	250					250
Net income	15,000	500			10,000	4,500
Sale of Bonds	17,000	—	5,250	6,000	—	5,750
Sale of Capital Stock	12,000	—	—	—	—	12,000
TOTAL	57,000	8,500	10,000	6,000	10,000	22,500

*By preparing this type of 'All inclusives statement' one can criticise the individual source, if applied to a particular use. e.g. if loan is taken to retire an old debt, it would amount to borrowing to repay a part borrowing.

It would be better if Cash-flow statement is prepared.

All elements should be shown coordinated and should be matched so as to reveal, the financial effects of transactions, events, and managerial decisions.

VI

MANAGERIAL USES

The preparation of funds flow statements has aided to achieve clarity in accounting. It is being upgraded from its mere status as supplemental schedule to rank as a basic financial statement.¹⁰ Not only the outside parties but management too find them as a useful device for solving a number of ticklish and otherwise difficult problems. From the management point of view, the major uses are given below.

TO DETERMINE THE FINANCIAL CONSEQUENCES OF OPERATIONS

Sometimes it happens that income statement,—though discloses attractive profits, sufficient cash is not available to declare dividend

and thus pay the dividends. A business concern may operate profitably every year and still it finds itself in financial distress. Funds statement which is essentially a statement of sources and application of funds will provide a clear picture of what has become of net profits and the funds obtained from other sources. {“Funds flow statements are designed to fill in the financial blind spots of the operating statement. They translate the economic consequences of operations into their financial counterparts. And although the total economic values of the firm may have increased during the period of operations, the change in the liquidity of those values and in their sources may have restrictive, if not damaging implications.”¹¹}

AID IN PROCURING NEW FINANCES

✓ A banker (or any lender for the purpose of a loan) while advancing a loan is certainly interested in such questions as the amount of loan, the purpose of loan, the repaying capacity, the sources of repayment etc. Funds flow statement, in most cases, obviously provides clues leading to answers of these questions by specifying the various sources and application of funds. ✓

ALLOCATING THE FINANCIAL RESOURCES

✓ An enterprise always needs more money than is readily available and this raises the problem of allocation—a feature common to all economic activities. Management has to allocate small resources to the strategic projects on the assumption that all cannot be implemented. This definitely requires the assignment of preferences to different projects. Funds flow statement helps in ascertaining the ‘funds’ that would materialise to meet the ‘strategic needs’ while other needs can be deferred or postponed. ✓

EVALUATING THE OPERATIONAL ISSUES

The basic operations of a business are of financial character and their success or failure would be ascertained after the lapse of some period. The funds flow statement enables to find out the trend of the success or failure of the operations and the available resources to deter-

mine the critical timings, e.g., if a businessman continues to draw more than his earnings from the operations, he is bound to become financially bankrupt in course of time. The use of the funds statement is an analytical guide to accomplish this objective.

FURNISHING WORKING CAPITAL

Although a broader approach has been followed in the preparation of funds statement, its primary use is to furnish working capital, a term which denotes the continual revolving of current assets and liabilities from one form to another and the balance has to be struck between customer's desire and firm's willingness. Customers insist upon credit while the firm would be interested in cash and other most liquid assets. The magnitude of investment in working capital is an important part of managerial decision-making process and task is facilitated by the funds statement.

PLANNING AND CONTROL

Management and even the outside parties concern themselves in an information system oriented towards strategic planning and control of business organisations. "This places a particular and proper emphasis on the pre-eminence of the statement of sources and uses of working capital. The reason for this is that the behaviour of funds flow figures relates closely to the criteria upon which management strategy is based."¹²⁻¹⁰

VII

In this final section the endeavour is to study the feasibility of having a combined *income-fund* statement. Several viewpoints exist which explain the significance of position statement, income statement and funds statement.

One set of opinion feels that funds flow statement is merely a supplemented schedule and it contains only derivative figures obtainable from income and position statements. It is understandable from this viewpoint that funds statement has a low status and hence the question of combining it with income statement does not arise.

A second viewpoint argues that the funds statement must rank equally with the income and position statement since each of three depicts one aspect of the financial statistics.

A third viewpoint suggests that it is possible to have only position statement and combined income-funds statement. It is, therefore, clear that according to them a merger is possible. But this point I must be further elaborated to ascertain the specific implications. The contention is that the information contained in the income statement can be suitably obtained the mere preparation of funds statement alone. But it is, however, to be noted that income statement consists of items of revenues and expenditure for the specific accounting period alone and what is left is either the sources or use of the funds from operations after making the necessary adjustments for depreciation gains or losses. And just to incorporate this source or use of fund, the form of funds statement will have to be drastically modified and in the process the very purpose of the funds statement is liable to be defeated. The analyst will find himself in a very complicated situation as he may not be able to understand the large mass of data in one statement. It may also induce the accountant to conceal some important facts by manipulating the figures. The funds statement is not statutory governed to have accounting period as the basis and is very helpful in the determination of liquidity trends which sometimes cut across the limits of time. The best course is always to have three separate statements so as to enable the extraction of maximum data, facts and other relevant information.

REFERENCES

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7. Foulke, R. A. : *Practical Financial Statement Analysis*, op. cit., p. 475.

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9. *Ibid.* p. 485.
10. "The funds statement should be treated as a major financial statement. It should be presented in all annual reports of corporations and be covered by the auditor's **show** form report". See Charles T. Horngren, "Increasing the utility of financial **state-**ments", *Journal of Accountancy*, July, 1959, p. 40.
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12. See Colin Park, "Funds Flow", *Modern Accounting Theory*, *op. cit.*, p.302.