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Funds Flow Statement

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Abstract:

Financial management is a service activity which is concerned with providing quantitative information which is of financial nature which may be needed for making Economic decisions regarding the choice among alternative course of actions. The financial management is a process of identification accumulation, analysis preparation interpretation and communication of financial information to plan evaluate and control a business firm. Financial management is that specialized function of general management which is related to the procurement of finance and its effective utilization for the achievement of the goals of an organization. Finance may be defined as the provision of money at the time where, it is required. Finance refers to the management flews of money through an organization. It concerns with the application of skills in the manipulation, use and control of money. Different authorities have interpreted the term "finance "differently. However there are three main approaches to finance.

- *The first approach views finance as to providing of funds needed by a business on most suitable terms this approach confines fiancés to the raising of funds and to the study of financial institutions & instruments from where funds can be procured.*
- *The second approach relates fiancé to cash.*
- *The third approach views fiancé is being concerned with raising funds & their effective utilization.*

Key words: *Financial Markets and functions, financial Policy, Funds flow activities…*

Introduction:

The basic financial statements i.e., the balance sheet and profit and loss account to income statement of business reveal the net effect of the various transactions on the operational and financial position of the company. The balance sheet gives a summitry of the assets and liabilities of an undertaking at a particular point of time. It reveals the financial status of the company. The assets side of a balance sheet shows the development of resources of an undertaking while the liabilities side indicates its obligation, i.e., the manner in which these resources were obtained. The profit and loss account reflects the results of the business operation for a period of time. It contains a summary of expenses incurred and the revenue realized in an accounting period. Both these statements provide the essential basic information on the financial activities of business, but their usefulness is limited for analysis and planning purpose. The balance sheet gives a static view of the resources (liabilities) of business and used (assets) to which these resources have been put at a certain point of time. It does not disclose the causes for profit and loss account, in a general way, indicates the resources provided by undertaking and which do not operate through profit and loss account. Thus, another statement has to be prepared to show the change in the assets and liabilities from the end of one period of time to the end of another period of time. The state is called a statement of changes in financial position or a funds flow statement. The funds flow statement is a statement, which shows the movement of funds and is a report of the financial operations of the business undertaking. It indicates various means by which funds were obtained during a particular period and the ways in which these funds were employed. In simple words, it is a statement of sources and application of funds. A financial statement is a collection of data organized according to logical and consistence accounting process .Its purpose is to conveyer an understanding of some financial aspects of a business firm. Its may show a position at a moment in time, as in the case of an income statement. Thus the term "Financial statements" generally refers the statements.

i) The position statement or the balance sheet and

ii) The income statement or profit and loss account

These statements are used to convey to management and other interests outsiders the profitability and financial position of a firm.

NATURE OF THE FINANCIAL STATEMENTS:

The financial statements are prepared on the basis of recorded facts. The recorded facts are those which can be expressed in monitory terms.

I) RECORDED FACTS: The terms and 'recorded facts' refers to the date taken out from the accounting records. The records are maintained on the basics of actually cost data.

II) ACCOUNTAING CONVENTIONS: Certain accounting conventions are followed while preparing financial statements. The conventions of valuing inventory at cost are market price, whichever is lower, is followed.

III) POSTULATES: The accounting makes certain assumption assumptions while making accounting records. One of these assumptions is that the enterprise while making accounting records. One of these assumptions is that enterprise is treated as a going concern. The other alternative to this postulate is that the concern is to be liquidated. Another important assumption is to presume that the value of money will remain the same in different periods. While remain the remain the same in different periods. While preparing profit and loss account the revenue is treated in the year in.The term flow means movement & includes both 'inflow' & 'outflow'. The term flow of funds means transfer of economic values from one asset of equity to another. Flow of funds is said to have taken place when any transaction makes changes in amount of funds available before happening of transactions. If the effect of transaction results in increase of funds. It is called a "source of funds" and it is results in decrease of funds, it is known as an application of funds.

1. **BALANCE SHEET:**

The American institute of certified public contents defines balance sheet as" A tabular statement of summary of (Debits and Credits) carried forward after an actual and constructive closing or books of account and kept accounting to principles of accounting".

2. **INCOME OF STATEMENT ACCOUNTING): ENT (PROFIT AND LOSS)**

Income statement is prepared to determine the operational position of the concern. It is a statement of revenue earned and expenses, incurred for earning that revenue.

3. **STATEMENT OF CHANGES IN OWNERS'EQUITY (RETAINED EARNINGS)**

The terms' owners equity' refers to the claims of the owners' of the business (share holders) against the assets of the firm. It consists of two elements 1) paid up share capital,2) retained earnings or reserves and surplus.

4. **STATEMENT OF FINANCIAL POSITION:**

The basic financial position i.e.., the balance sheet and the profit and loss account are income statement of a business reveals the net effect of the various the transactions operational and financial position of the company.

A) FUNDS FLOW STATEMENTS:

The Funds flow statements is designed to analyze the changes in the financial condition of business two periods. The word "Fund" is used to denote working capital. This statement will show the sources from each the funds are received and the uses to which these have been put.

B) CASH FLOW STATEMENTS:

A statement of changes in the financial position of a firm on cash basis is called cash flow statements. It summarizes the causes of changes in cash position of a business enterprises between dates of two balance sheets This statement is very much similar to the statement of changes in working capital i.e. Funds flow statements.

THEORETICAL CONCEPTS:

Management may be defined as optimum utilization of available resources keeping in view the overall objectives of the firm. Here fund management is nothing but, utilization of available funds at optimum level with a view to achieve the overall objectives of the organization. This includes mobilizing or rising of funds from different available sources and investing or allocating these funds in an efficient way, which yields the optimum returns, so that the firm can achieve its overall objectives.

MEANING OF FUNDS:

According to the international Accounting standard No. 7, the term Fund generally refers to cash and cash equivalents, or to working capital, of these, the last definition of the term (i.e., working capital) 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. Net working capital means, excess of current assets over current liabilities. It is in the later sense in which the term funds is generally used.

According to the American Institute of Certified public Accounts (AICPA),the meaning of two terms current assets and current assets and current liabilities are as follows:

CURRENT ASSETS:

The term current asset's includes assets, which acquired with the intention of converting them into cash during the normal business operations of the firm.

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 asses in the same balance sheet or creating of other current liabilities or those expected to be satisfied with in a relatively short period of time usually one year (AICPA).

FUNDS FLOW:

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 Glow of funds.

In business several transactions take place. Some of these transactions increase the fund while others decrease the funds. Some may not take any change in funds position. In case a transaction results in increase of funds, it will be termed as a source funds In the same way, decrease of funds would result as an application or use of funds.

THERE WILLBE FLOW OF FUNDS OF A TRANSACTION INVOLVES:

- Current assets and fixed assets (e.g. Purchase of building for cash).
- Current assets and capital (e.g. Issue of shares for cash)
- Current assets and fixed liabilities (e.g. Redemption of long term borrowings in cash).
- Current Liabilities and fixed liabilities (e.g. Creditors paid off in debentures)
- Current Liabilities and fixed liabilities (e.g. Creditors paid off in debentures)
- Current Liabilities and capital (eg.Creditors paid off in shares).
- Current Liabilities and fixed assets (e.g. Buildings transferred to creditors in satisfaction of their claims).

<u>SOURCES AND APPLICATION OF FUNDS:</u>

SOURCES OF FUNDS:

The sources of funds can both internal as well as external.

INTERNAL SOURCES:

Funds from business operations are the only internal sources of funds. This can be arrived by deducting the non – operating expenses (e.g. Depreciation) and adding the non -operating incomes (e.g. are Profit from sale of fixed asset.

EXTERNAL SOURCES:

These funds include

FUNDS FROM LONG-TERM LOANS:

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

SALE OF FIXED ASSETS:

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

INCREASE IN SHARE CAPITAL:

Issue of shares for cash or for any other current asset result in increase in working capitalis hence there will be flow f funds.

APPLICATION OF FUNDS:

The used to which funds are put are called application funds. Following are some of the purposes for which, funds may be used.

PURCHASE OF FIXED ASSETS:

Purchase of fixed assets such as land, plant, machinery, long-term investments etc., and result in decrease of current assets without any decrease in current assets without any decrease in current liabilities. Hence there will be a flow of funds.

PAYMENT OF DIVIDENDS:

Payment of dividends results in decrease of a fixed liability and therefore, it affects funds.

PAYMENT OF FIXED LIABILITY:

Payment of long-term liability, results in reduction of working capital and hence it is taken as an application of fund.

SOURCES AND EMPLOYMENT OF BANK FUNDS PAID – UP CAPITAL ANS RESERVES:

The paid – u capital and cash reserved of a commercial bank constitute by far the most dependable source of bank liquidity. The paid-up capital comprises of the cash amount contributed in cash by public on their shares to the bank. The paid – up capital is less than authorized capital and it is either equal to or less than the subscribed capital. Authorized capital is the maximum, which a bank can issue for public subscription under its Memorandum of Association. Generally, the board of Directors of a bank does not issue the entire authorized capital for subscribed by the public. If the entire subscribed capital is not paid-up capital. A part of the subscribed capital may be paid subsequently, when asked by the

board of Directors. The among which is subject to call is known as the Reserve Liability. For the sake of safety, a commercial bank keeps a reserves fund, which is created out of the undistributed profits every year. The bank draws upon the resources of its reserved funds in periods of losses. In India, every commercial bank is legally required to set apart of its profit for the resave fund, until the fund becomes equal to its paid-up capital. Besides, commercial banks also maintain secret reserves, for bad and doubtful debts and depositor equalization fund crated out of profits. The paid-up capital and reserves of bank provide protection to the depositors of a bank, when it faces the danger of liquidation. To the extent, these funds represent the owned funds of the bank, it is this source of bank liquidity upon which the bank fails in times of financial crises when its capacity to meet its financial commitments toward is depositors is impaired. Infect, the ability of a commercial bank to withstand successfully any crisis of confidence of its depositors in its credit worthiness depends largely upon the size of its paid-up capital and cash reserved that are available to it as a cushion to absorb any shock it might receive at the hands of its scared depositors. Low paid – up capital and meager cash reserves and a bank ill go together.

DEPOSITS:

Next to the paid – up capital and cash reserves, the other most importance sources of supply of commercial bank liquidity is the deposits which banks receive from their depositors comprising of individuals, corporate form of business enterprise, firms and other including educational institutions, local bodies and government. The depositors of a bank are drawn from all walks of life residing in the urban, Simi urban and rural areas of the country pursuing allsorts of conceivable vocations, so much important are the single source of bank liquidity supply that banks often engage in keen competition for deposits mobilization because the capacity to mobilize deposits. But for the large funds, which banksreceive as deposits their investment and lending activities would have been on considerably smaller scale than these, in fact, are. Bulk of the total earnings of commercial banks in derived in the form of interest income derived from loans and advances made by the banks to trade, industry and other borrowers and the interest earned From investments made in the government and other securities. The extent to which banks can grant loans to their constituents depends in the amount of liquidity they command and deposits are the single largest source of the composite supply of their total liquidity.

OTHER LIABILITIES:

A part form the paid up capital, cash reserves and deposits, the other principal components of the liabilities portfolio of banks are the borrowings, which the commercial banks make from the central bank is barometer of the degree of the borrower – lender relationship which exists between the banks and the central bank and consequently of the dependence of the former upon the latter in the country. This relationship is very significant in the matter of enabling then central bank to exercise an effective control over the credit creation activities of the banks in the economy. The degree to which the member banks depends for financial accommodation on the central bank is a measure of the degree of effectiveness of the latter in influencing the lending or credit – creating activities of the former and consequently of the effectiveness of central banks monetary and credit policy in achieving the desired economic goals. In India, the banks borrow from the Reserve bank of India and the sum borrowed varies depending upon the busy stack season and the liquidity position of the banks.

ASSET PORTFOLIO:

Having briefly discussed the main sources of supply of funds of banks. Let us now very briefly discuss the uses to which these funds are it by the banks. The most profitable activity of banks consists of lending surplus cash either by way of making loans or granting overdraft facilities of their customers. While banks are anxious to utilize their funds in such a manner so as to optimizes their net income from the use of these Responsible bank personnel bank manager and other), Who look after the manner of utilization of the surplus funds have always to remember the hard fact that the ownership of such funds as they have acquired (barring paid up capital and reserves) vests in the depositors whose autonomous decision to with draw their deposits as and when they please(subject to certain bank rules which they have agreed to abide by) have to a scrupulously respected by refunding then their deposits promptly on demand the acquired funds to their owners or persons named by them. A part from cash in hand, cash balances held with the central bank and balances held with the other banks which, constitute the first defense for banks as these can be acquired immediately without any cost, the other asset ranking next to cash money at call and short – notice comprising of short-term loans callable at very short notice. As money at call convertible into cash without notice, it commands on attribute of high liquidity ranking next to cash. It earns a very low rate of interest for the bank. So also is the case with

money callable at short notice. However, since compared with money at call it is relatively less liquid the yield is slightly higher. Money at call and shortnoticeconstitutes a larger money markets compared with those countries which have developed money markets compared with those whose money markets are either not developed or not properly functioning. Such is the situation in most developing countries.A part from cash in hand and balances with the central bank balances with the central bank, balances with other banks and call and short notice, the two principal items of the asset0 portfolio of banks are the advances or bank credit and investment made in government securities includes the treasury bills, which habe of 91 days, in India, banks make investments both in the central government and state governments securities of differing maturities.

APPROACHES TO FUNDS MANAGEMENT OF BANKS:

There are now two broad or general approaches to the bank fund utilization. These are the pooled- funds approach and the asset allocation approach.

The pooled – funds approach is based upon the belief that the commercial banks employ their funds in creating different types of assets assorted assets comprising of different land, securities, of supply of their funds . Where most of the commercial bank are derived from a single soured this approach works our satisfactorily. For instance, in the past when bulk of the commercial bank funds constitutes the demand deposits it was need less of differentiate between the different sources of supply of bank funds .But now a days, it is argued by the critics off this approach, when the deposit –mix of commercial banks has radically changed and keeps in continuously changing under the impact of dynamics of growth, the pooled funds approach is absolute and is detrimental top the realization of optimum yield from bank funds as it ties liquidity to total deposits among which can do without maintaining the same high ratio of liquidity which they might consider essential to maintain against the demand deposits deposit. Consequently, the pooled- funds approaches, which take no notice of the changing pattern of the total

deposit – mix of commercial banks, is faulty and lead to in efficient conduct of banks asset portfolio management.

The Asset – allocation approach to which has been developed in recent years, stresses that the investments made in different types of Assets have to be directly related to the different sources.

From which funds are derived by the bank thus, the fundamental criteria which must be followed in allocated funds for acquiring different sources of applying of funds determine the appropriate maturity of the assets acquired through funds utilizations. For instance, while relatively stable funds, Like fixed deposits and paid – up capital, could be used to buy along dated high-yield for giving securities, demand deposits, saving deposits, which are most volatile, could be used to acquire relatively liquid assets like cash or money at all call and short notice on which little or of no return is made by the banks.

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