

**C H A P T E R : V****FUNDS FLOW ANALYSIS**

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**CHAPTER : V**  
**FUNDS-FLOW ANALYSIS**

**5.1 INTRODUCTION :**

The funds flow statement is neither a substitute for balance sheet nor a supporting schedule to it. The balance sheet is a static statement simply listing the firms resources such as cash, account receivables, plant and machinery, etc. On one hand and the claims against those assets on the other hand. It is prepared at the end of accounting period and a going concern value of these assets and liabilities. It reveals the financial position of the firm at a certain point of time. Its usefulness is limited to analysis and planning purposes. Its nature is of historical character and static and it does not meet the dynamic requirements of the firm's financial management. A financial executive must know the funds-flow underlying the balance sheet changes.

**5.2 CONCEPT OF FUNDS :**

The term 'Fund' is used in three different meanings : In its narrow sense, it is taken as 'Cash'. When it is taken as 'Cash', the statement prepared is termed as "Cash flow statement" which shows incoming and outgoing cash only. This is a narrow concept because all movements which affect the financial position of a business but which do not involve cash receipt or payments fall outside the scope of the term 'fund'.

The term 'fund' when used in its broadest sense, it covers all assets and all liabilities. The entire assets side shows uses of funds whereas the entire liabilities side shows the sources of funds.

The above two concepts are the two extremes, and the most accepted concept is the "Working capital concept". This concept covers all movements that affect the working capital. Any movement which increases working capital is a source of fund and any movement which decreases working capital is an application of fund. The drawback of this concept is that, it does not take into consideration the movements not affecting the working capital, e. g. purchase of machinery by issue of shares or repayment to the creditors.

### 5.3 SOURCES OF FUNDS:

Generally speaking, funds are derived from :

1. Operation of business ;
2. Income from investments;
3. Sale of fixed assets and long term investments.
4. Contribution of shareholders.
5. Increase in long term liabilities, e.g.  
Issue of debentures.
6. Gifts, damages awarded in legal actions, etc.

### 5.4 USES OR APPLICATIONS OF FUNDS :

Uses of funds are more numerous but the principal categories are :

1. Operating losses.
2. Repayment of long-term loans and debentures
3. Redemption of share capital
4. Payment of cash dividends
5. Acquisition of fixed assets
6. Purchase of long-term investments
7. Loss of cash by embezzlement, costs in legal action etc.

#### 5.5 CONCEPT OF FLOW :

The 'flow' of funds refers to transfer of economic values from one asset to another, from one equity to another, from an asset to an equity or vice versa or a combination of any of these. According to working capital concept of funds, the 'flow' of funds refers to movements of funds described in terms of the flow in and out of the working capital area. This occurs when changes occurring in non-current accounts are off-set by corresponding changes in current accounts and vice versa; e.g. cash purchase of machinery.

#### 5.6 MEANING OF FUNDS FLOW STATEMENT :

The funds statement is a method by which we study the net funds-flow between two points in time. The points conform to beginning and ending financial statement dates for any relevant period, a quarter or a year. Mr. Foulke defines this statement as follows :

"A statement of sources and Application of funds is a technical device designed to analyse the change in the

financial condition of a business enterprise between two dates."

Thus a funds-flow statement is a report on financial operations changes flows or movements during the period. Here the term funds denotes the 'Working Capital'. Working capital is often regarded as the difference of current assets and current liabilities. Hence the terms 'fund' and 'Working capital' are synonymous.

#### 5.7 MANAGERIAL USES OF FUNDS FLOW ANALYSIS :

The funds-flow statement is a useful tool in the financial manager's analytical kit. The basic purpose of this statement is to indicate where funds came from and where they were they were used during the certain period. It provides the following main services :

1. A funds-flow statement gives a rich insight into the financial operations of a firm.
2. One important use of funds-flow statement as in the evaluation of the firm's financing.
3. The funds-flow statement clearly defines the past flow of funds and gives insight into the evaluation of the present situation.
4. An analysis of a fund statement for the future is extremely valuable to the financial manager in planning the intermediate and long-term financing of the firm.

#### 5.8 LIMITATIONS OF FUNDS FLOW STATEMENT :

1. It is undoubtedly true that the statement does supply information not otherwise available in the

conventional statements but, as it ignores non funds transactions, it is a cruder device than the income statement and balance sheet.

2. The funds flow statement does not introduce the original evidence of financial status or change but merely rearranges data appearing elsewhere in accounts.

3. It is said that even more important than the changes in working capital is the change in cash.

4. Though attempts are made to project the funds statement in future it is essentially historical in nature.

#### **5.9 FUNDS FLOW ANALYSIS IN THE STUDY OF LIQUIDITY :**

Both the sources and uses of funds can be subdivided in to short term and long term. If for a given year, the long-term sources are more than the long-term uses, it results in an increase of the 'Net working capital'. It implies that there is an improvement in liquidity. On the other hand if long-term uses are more than the long-term sources, it means that the deficit is made good from short term sources, thus weakening the liquidity position.

#### **5.10 PREPARATION OF FUNDS FLOW STATEMENTS :**

Now let us prepare funds flow statements of the Bank for last ten years.

TABLE 5.1 (A)  
CALCULATION OF FUNDS FROM OPERATIONS OF THE BANK FOR THE  
YEAR ENDING 30TH. JUNE 1985.

Particulars	Rs.	Rs.
Net profit as per profit & loss a/c		4,23,480
Add : Depreciation of fixed assets charged to p&l a/c		58,801
Total appropriation of retained Earnings		21,592
Income Tax		7,692
		<u>5,11,565</u>
Less : Dividend received from out-side credited to P&	21,190	
Rent received on building	<u>48,004</u>	69,194
Funds from operations		<u><u>4,42,371</u></u>

SOURCE : Profit & loss a/c of the Bank.

TABLE 5.1 (B)

## STATEMENT OF CHANGES IN WORKING CAPITAL OF THE BANK.

	1984	1985	Changes in working capital	
	Rs.	Rs.	Increase Rs.	Decrease Rs.
<b>CURRENT ASSETS</b>				
Cash	1638375	2984772	1346337	
<b>LOANS :</b>				
Short term loans	6965256	10447654	3482398	
1/5th of medium term Loans	6246709	6754391	507682	
Interest receivable	421109	548770	127661	
Stock	77152	62850		14302
Other debts	66426	30330		36096
Dr. balance of Karad Society	—	5612	5612	
	<hr/>			
Total :(A)	15415027	20834319		
<b>Less :</b>				
<b>CURRENT LIABILITIES :</b>				
12.22% of time deposit	992451	1390530		398079
Savings deposit	4349570	6075360		1725790
current deposit	1362	12564		11202
Nishkriya dposit	13558	6438	7120	
Matured time deposits	—	28064		28064
Loans from D.C.C. Bank	10550000	9050000	1500000	
<b>Interest payable :</b>				
on Subs-cription	6324	6778		454
on 1/7th of Int. on deposits	396153	564970		168817
On D.C.C. Bankloans	102027	82258	19769	
Other Crditors	168557	184471		15914
Reserve for Doubtfull debts	33305	36305		3000



Reserve for Int. on Doubtfull debts	5940	6200		260
Reserve for Building Repaiaaring	48988	7000	41988	
Total (B)	<u>16668235 17450938</u>			
Working capital (A-B)	-1253208	3383381		
Increase in working capital	4636589			4636589
	<u>3383381 3383381</u>		<u>7038567</u>	<u>7038567</u>

SOURCE : Balance Sheets of the Bank.

TABLE 5.1 (C)

FUNDS FLOW STATEMENT OF THE BANK FOR THE YEAR ENDING 30<sup>TH</sup> JUNE, 1985

SOURCES	Rs.	APPLICATIONS	Rs.
<u>SHORT TERM SOURCES</u>		<u>SHORT TERM APPLICATIONS</u>	
Balance amount of funds from operations after transferring amount to Genral reserve		Increase in working Capital	46,36,589
dividend received		Income Tax paid	7,692
Building rent Rceived	3,36,501	dividend Paid	2,07,222
	21,190		
	48,004		
	<u>4,05,695</u>		<u>48,51,503</u>
<u>LONGTERM SOURCES :</u>		<u>LONG TERM APPLICATIONS</u>	
Issue of shares	6,13,550	Purchase of Investments	21,91,785
long-term deposits	71,23,296	medium-term loans	20,30,727
		Eraction of building	27,205
		Purchase of furniture	1,58,051
Inton long term deposits	10,12,907	Purchase of Books	60
		Other fixed assets	
Membrs Subscription	1,400	Purchased	3,387
25% of profit which is transferred to General reserve	1,05,870		
	<u>88,57,023</u>		<u>44,11,215</u>
Total	<u>92,62,718</u>	Total	<u>92,62,718</u>

SOURCE : Annual Reports of the Bank.

In this year, the long term sources are more than the long term uses, it results in an increase in net Working Capital by the amount of Rs.44,45,808. It indicates that there is an improvement in liquid position of the bank.

From the funds flow analysis, we can say that the overall creditworthiness of the bank is good because the bank had more long term sources and less long term applications. Also bank is having good internal sources. Bank has tried to increase the Working Capital and make it effective use. During the year, Bank had made investment in some fixed assets and still there is sufficient amount of Working Capital due to its sufficient long-term sources. In this year the bank had made maximum investment in current assets and therefore, the bank will be in a position to get funds when they are needed.

It will be time consuming and too elaborate, if we prepare statement of changes in Working Capital and the funds-flow statements for all the ten years. Therefore, we have prepared these two statements for the year 1984 and 1985 and for the rest of the period, we will prepare the funds-flow statement in a tabular form. We will divide the statement into two parts.

- a) Short-term sources & their application
- b) Long-term sources & their application

TABLE 5.2  
TABLE SHOWING FUNDS-FLOW STATEMENTS OF THE BANK FOR THE YEARS ENDING 1986 TO 1994

	Years									
	1986	1987	1988	1989	1990	1991	1992	1993	1994	
TABLE 5.2 (a)										
SHORT TERM SOURCES AND THEIR APPLICATION										
	(Rs. in lakhs)									
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SHORT TERM SOURCES										
1 Balance amount of funds from operations after transferring amount to General reserve	6.23	8.94	10.84	13.93	16.41	17.56	23.44	49.60	38.38	
2 Dividend received	0.26	0.29	0.33	0.37	0.47	0.52	0.72	0.64	0.99	
3 Building rent received	0.48	0.48	0.43	0.42	0.43	0.42	0.31	0.41	0.42	
4 Decrease in working capital	-	-	-	-	15.63	47.59	-	-	13.04	
<b>Total</b>	<b>6.97</b>	<b>9.71</b>	<b>11.60</b>	<b>14.72</b>	<b>32.94</b>	<b>66.09</b>	<b>-24.47</b>	<b>50.65</b>	<b>52.83</b>	
<hr/>										
SHORT TERM APPLICATION										
1 Increase in working capital	112.97	39.76	44.42	44.28	-	-	82.57	195.36	-	
2 Income Tax paid	0.07	0.07	0.05	0.03	0.02	0.03	0.03	0.02	0.03	
3 Dividend paid	2.96	5.06	7.21	8.54	9.91	12.09	14.21	14.38	33.72	
4 Non trading payments	0.39	0.42	0.62	0.82	0.90	1.04	0.78	1.60	3.35	
<b>Total</b>	<b>116.39</b>	<b>45.31</b>	<b>52.30</b>	<b>53.67</b>	<b>10.83</b>	<b>13.16</b>	<b>97.59</b>	<b>211.36</b>	<b>37.10</b>	

TABLE 5.2 (b)  
LONG-TERM SOURCES AND THEIR APPLICATION

(Rs. in Lakhs)

	Years								
	1986	1987	1988	1989	1990	1991	1992	1993	1994
<b>A) LONG TERM SOURCES :</b>									
1) Issue of shares	8.45	8.23	10.05	7.97	22.58	25.06	10.71	16.83	32.98
2) long term deposits	92.04	98.92	119.91	117.69	157.65	175.72	85.98	203.51	225.57
3) Int. on long term deposit	11.64	18.57	24.84	26.68	24.51	27.09	6.76	40.67	43.96
4) Members subscription	0.01	-	-	-	-	-	-	-	-
5) 25% of profit which is transferred to general reserve	1.84	2.60	3.18	4.00	4.82	5.19	7.40	15.61	11.41
6) Decrease in medium-term loans	18.92	-	-	-	-	-	14.11	-	-
7) Sales of furniture	0.02	-	-	-	-	-	-	-	-
8) Other fixed assets sold	0.78	0.13	-	0.67	-	-	-	6.83	-
9) Decrease in long term loans	-	-	-	-	-	-	-	-	4.14
<b>TOTAL (A)</b>	<b>133.70</b>	<b>128.45</b>	<b>157.98</b>	<b>157.01</b>	<b>209.56</b>	<b>233.06</b>	<b>124.96</b>	<b>283.45</b>	<b>318.06</b>
<b>B LONG TERM APPLICATIONS</b>									
1) Purchase of Investments	23.60	21.98	31.41	32.52	47.15	55.30	29.95	39.21	65.95
2) Eraction of Building	0.28	-	-	-	0.07	0.31	5.51	1.19	0.60
3) Medium term loans given	-	65.21	73.57	69.77	168.80	211.71	9.48	67.01	263.12
4) Purchase of furniture	0.38	0.39	1.44	1.33	4.20	2.97	0.49	10.23	2.91
5) purchase of vehicle	0.01	0.01	-	0.01	-	0.01	0.01	0.01	-
6) Other fixed assets Purchased	-	-	3.14	-	0.09	1.04	6.40	-	1.20
7) Purchase of Books	0.01	-	0.01	-	-	-	-	-	0.01
8) Long term loans given	-	5.26	7.16	14.43	11.36	14.65	-	5.09	-
9) Members subscription Repaid	-	-	0.55	-	-	-	-	-	-
<b>Total (B)</b>	<b>24.28</b>	<b>92.85</b>	<b>117.28</b>	<b>118.06</b>	<b>231.67</b>	<b>285.99</b>	<b>51.84</b>	<b>122.74</b>	<b>333.79</b>
increase in working capital (A-B)	109.42	35.60	40.70	38.95	-	-	73.12	160.71	-
Decrease in working capital (B-A)	-	-	-	-	22.11	52.93	-	-	15.73

SOURCE : Annual Reports of the Bank.

After going through the table no. 5.2, we find that:

1985-86 :

In the year 1985-86, the bank had very high long term sources and very few long term applications but the bank had sanctioned only few medium & long term loans even though the actual capacity of the bank to sanction long-term loans was more. Because of excess of long-term sources than the long term applications, the working capital of the bank had increased by Rs. 109.42 lakhs. The Bank was having good internal sources, such funds from issue of shares, funds from operations and building rent etc.

From the above analysis we can say that there was an improvement in liquidity position of the Bank and credit worthiness of the Bank was good. During the year the Bank was good. During the year the bank had generated funds from operations to the extent of Rs. 8.07 lakhs.

1986-87 :

In the year 1986-87, the long term sources of funds are more than the long term uses of the funds and this has resulted in an increase in net working capital of the bank by Rs. 35.60 lakhs. It indicates that there is an improvement in liquid position of the bank. But during this year, the long term applications were more than the long term applications of the last year, and still the bank was having sufficient working capital.

1987-88 :

In 1987-88, the long term sources are more than the

long-term uses of the funds. It has resulted into increase in net working capital of the Bank by Rs. 40.70 lakhs. It shows that there is an improvement in liquidity position of the Bank.

During the year, the Bank had received funds from internal sources to the extent of Rs. 24.83 lakhs. This suggests that the credit worthiness of the bank was improved.

From the above analysis, we can conclude that the bank has always been trying to increase its working capital and maintain good liquidity position. The overall financial policies of the Bank were conducive for its growth.

**1988-89 :**

In the year 1988-89, the long-term sources of funds were more than the long-term uses of the funds. This resulted in an increase in the net working capital of the bank to the extent of Rs. 38.95 lakhs. It indicates that there was an improvement in liquid position of the Bank.

During the year, the bank had received funds from internal sources to the extent of Rs. 26.69 lakhs. It implies that the credit worthiness and financial policies of the Bank were good.

**1989-90 :**

During the year 1989-90, the long-term applications of funds were more than the long-term sources of the funds, it resulted in a decrease in net working capital of the Bank to the extent of Rs. 22.11 lakhs. This means that the deficit was made good from short-term sources, thus weakening the liquidity position of the Bank. The Bank was not having sufficient working capital and creditworthiness of the Bank was poor.

During the year, the Bank had used Rs. 21.23 lakhs as funds from operations and the funds from internal sources to the tune of Rs. 44.71 lakhs. Thereafter, banks liquidity position was not good due to excessive long term uses.

**1990-91 :**

In the year 1990-91, the long-term uses of funds are more than the long-term sources of the funds. This has resulted in a decrease in net working capital of the bank to the extent of Rs. 52.93 lakhs. It means the deficit was made good from short-term sources, thus weakening the liquidity position of the Bank.

During this year, the Bank derived Rs. 22.75 lakhs as funds from operations and Rs. 48.75 lakhs as funds from internal sources of the bank. But due to the overtrading, bank's liquidity position was not good.

**1991-92 :**

In the year 1991-92, the long-term sources were more than the long-term uses of the funds. It resulted in an increase in net working capital of the Bank, by Rs. 73.12 lakhs. This indicates that there was an improvement in liquidity position and creditworthiness of the Bank.

**1992-93 :**

In the year 1992-93, the long-term sources were more than the long-term uses of funds, This resulted in an increase in working capital of the Bank to the extent of Rs.



160.71 lakhs. This shows that there was an improvement in liquidity position and creditworthiness of the Bank.

During this year Bank has mobilised Rs. 65.21 lakhs as funds from operations and Rs. 83.09 lakhs as funds from internal sources of the bank. The Bank also paid dividend at the rate of 20% since it was having sufficient profits & sufficient fund year after year, the funds of the Bank from operations were also increasing.

1993-94 :

During the final year of our study i.e. year 1993-94, the Bank could derive Rs. 49.79 lakhs as funds from operations and Rs. 84.18 lakhs as funds from internal sources. But during this year, long-term uses of funds were more than the long-term sources of the funds. This resulted in a decrease in net working capital of the bank to the extent of Rs. 15.73 lakhs. It implies that the deficit was made good from short-term sources, thus weakening the liquidity position of the Bank.