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FUND FLOW STATEMENT: A TOOL OF ANALYSING CHANGES IN FINANCIAL CONDITIONS

Dr. Vikas Kumar Sudhakar
B. Com., M. Com., Ph.D
Guest Teacher, Dept. of Commerce, R. N. College, Pandaul, Madhubani,
L.N. Mithila University, Darbhanga.

ABSTRACT

A statement of fund flow illustrates the origins and applications of money into which fund are deposited. The term "fund" usually refers to working capital. For this reason, a fund flow statement is a technical instrument for demonstrating how a company's working capital situation evolves over time. The time period usually spans two balance sheet dates. The amount of money produced by the business is disclosed including internally the amount of money collected from different outside sources and the ways in which it was utilized throughout the year. The main goal is to analyze how net working capital—which is defined as current assets less current liabilities—varies over time. It shows the sources of the company's funds, such as profits, debt, or asset sales, as well as how those funds are used, such as for paying dividends, investing in assets, or repaying debt. By connecting the changes in the company's financial situation between two balance sheet dates to the profit and loss account, the fund flow statement helps to explain them.

KEYWORDS: *Current Assets, Current Liabilities, Financial Statement, Fund Flow Statement.*

INTRODUCTION:

A fund flow statement is a financial statement that compares a company's balance sheet from two consecutive years. It monitors the movement of money from the prior year to the current year, paying particular attention to the sources and uses of funds throughout the accounting period. Investors can use this analysis to assess the effect on the company's working capital.

Generally speaking, creating a fund flow statement entails examining fund flows in order to manage funds efficiently and maximize their use. By comparing inflows and outflows, this paper demonstrates changes in working capital, which helps to explain the causes of changes in financial statistics and helps assess a company's financial performance.

Any company's success depends on effective management of its finances and working capital. The source and use of funds can be determined with the help of a fund flow statement. This report sheds light on a company's liquidity, investment choices, and financial operations.

Balance sheets and profit and loss statements provide past and present figures, but they don't tell us why financial changes take place. The flow of funds statement explains the causes of variations in current assets and liabilities, providing a clearer picture of how profit converts into cash and highlighting any potential liquidity concerns.

A funds flow statement is a financial statement that examines a company's balance sheet over two years in order to confirm the movement of cash from the previous fiscal year into the current fiscal year. It will analyze the cause of inflows and outflows throughout the appropriate accounting period, as well as evaluate how they affect a company's working capital.

It is a crucial sign of how money is spent. In time, finance professionals will be able to use this declaration to assess the fund flow of an organization. Because it illustrates how money flows between various sources and its uses, it is sometimes referred to as the application of the Funds and the Statement of Sources.

The flows of funds are often analyzed prior to the preparation of these statements. It acts as a financial tool that enables firms to improve their financial management and keep track of how they spend their money.

COMPONENTS OF FUND FLOW STATEMENT

Sources of funds and uses of funds are the two primary elements of a fund flow statement. Where the money originates from is shown by the sources of funds, while how the money is used is shown by the applications of funds.

Sources of Funds:

Owners' Equity: It includes retained earnings and capital injection from owners. This covers bonds, bank loans, and other forms of long-term debt.

Sale of Assets: The proceeds from selling real estate, equipment, and structures are included in this category.

Decrease in Working Capital: This happens when a fall in current assets, such as inventory or accounts receivable, releases cash for other uses.

Uses of Funds:

Investments in Fixed Assets: This includes acquiring new plants, buildings, and other long-term assets.

Increase in Current Assets: This entails acquiring more inventory or accounts receivable.

Dividend Distributions and Loan Repayments: This involves making dividend payments to shareholders or repaying loans.

Increased Working Capital: This happens when current assets, such as accounts receivable or inventory, rise, resulting in more money being tied up**.**

Key Advantages of a Fund Flow Statement

- **Demonstrates financial status:** A flow of funds statement helps show the gain in profits, which is advantageous for shareholders.
- **Signifies an increase in share capital:** Changes in share capital may be brought to light by the statement of cash flows.
- **Displays an increase or decrease in share premium:** Variations in share premiums are seen in the fund flow statement. This rise is exacerbated when shares are issued at a premium or when preferential shares or debentures are reduced, and when the funds flow statement presents essential information at a glance.
- **Shows whether or not the business is making a profit or loss:** An organization's profitability or loss is evident from the fund flow statement.
- **Shows an increase in long-term borrowing:** By issuing debentures, the statement can indicate the additional amount borrowed.
- **Reveals a drop in working capital:** The decrease in working capital—that is, when current assets are less than current liabilities—is reflected in the statement.
- **The statement of cash flow serves as a guide:** By providing information about future challenges, demands, and fundraising demands, the statement helps the business prevent financial difficulties.

- **Useful for a sound dividend strategy:** There are occasions when a firm may make enough money, but it is still not a good idea to pay dividends because of a shortage of cash or liquidity. In order to inform a prudent dividend policy, the fund flow statement is helpful.
- **Useful for long-term borrowing:** To determine a company's creditworthiness before providing long-term loans, lenders may need many years' worth of fund flow statements.
- **Helpful advice for investors:** Some investors analyze a company's fund flow statements prior to making an investment in order to understand how the company generates and utilizes its funds (e.g., whether the funds are sufficient to cover interest and principal payments).

Preparation of Fund Flow Statement:

As mentioned below, a company must do a number of things in order to create a financial flow statement.

Step 1

A list of modifications to working capital will be prepared. Think about how the current liabilities and current assets have changed over time. Furthermore, keep in mind that the net working capital change is determined by the difference between current assets and liabilities.

Step 2

You should create an adjusted P&L account to calculate the Funds from Operations. This has to do with a firm's expenditure and income throughout its usual operations, not with its financial or investment operations. The corporation's yearly profit is subject to a number of changes. They include noncash costs like amortization and depreciation. In addition, the real cash produced by operational activities will be determined after deducting any profit made from selling assets and investments.

Step 3

In order to create a flow statement on the fund, you must define inputs and outputs. The balance sheet should also be utilized to create a fund flow statement by identifying the origin of cash, the direction of growth, or the direction of decrease in its use. When the data is complete, any net changes in working capital or cash from operations will also be taken into account.

Key benefits investors get from fund flow analysis

The Fund Flow Analysis is a great tool for potential investors to use in determining a company's ability to manage its finances effectively. Investors will then be able to assess the company's creditworthiness and determine if it is prudent to invest in that specific firm. Additionally, fund flow reports assist the organization's management in making sound decisions, which in turn allows the business to make the most of its resources and, ultimately, increase profits.

A Fund Flow Statement's Limitations

- Despite its importance in assessing a company's balance sheet, the statement has the following restrictions.
- The sole topic of this statement is the transfer of money. The balance sheet, profit and loss statement, and other factors are not taken into account. As a result, it must be examined in relation to the income statement and balance sheet.
- The company's cash position cannot be seen in the fund's flow statement. To assess the cash position, a different report on cash flows must be created.

CONCLUDING REMARKS:

A fund flow statement may be created with the use of a fund flow statement structure. Between the two balance sheets, the firm must issue a statement analyzing the changes in working capital. It helps management make decisions about the future. However, because it just considers financial items, management cannot base every choice only on a financial flow statement.

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