

FUNDS FLOW STATEMENT AND CASH FLOW STATEMENT

Let us take the following balance sheet and prepare the FFS and CFS.

Example 15.6:

Balance sheet of ABC Ltd is given in table 15.12.

Table 15.12		
Balance Sheet		
	2005	2006
Capital	50,000	55,000
Reserves	34,000	26,000
Creditors	12,000	3,000
	96,000	84,000
furniture	20,000	15,000
Plant	60,000	50,000
Cash	16,000	19,000
	96,000	84,000

Required: Funds flow statement and Cash flow statement.

Let us first prepare the statement of changes in the working. Statement of changes in the working capital as presented in the table 15.13 shows the current assets and current liabilities and the impact of the change in each item on the working capital

Table 15.13				
Statement of changes in the working Capital				
	2005	2006	Working Capital	
			Increase	Decrease
Current Assets	16,000	19,000	3,000	
Current Liabilities	12,000	3,000	9,000	
Working capital	4,000	16,000		
Increase in Working Capital	12,000	0		12,000
	16,000	16,000	12,000	12,000

To answer how did the company finance the increase in working capital one has to prepare the funds flow statement.

Increase in working capital can be financed by the following:

- Funds from financing decisions
- Funds from investment decisions
- Funds from operations

In the above example, the non-current items changes as follows:

- Capital: Increased by Rs. 5,000. We treat it as the increase due to the issue of new shares.
- Furniture: Decreased by 5,000. We treat it as the decrease due to the depreciation
- Plant: Decreased by 10,000. We treat it as the decrease due to the depreciation

So the funds generated from the financing decision is equal to the capital raised and there is no funds generated or lost from the investment decisions. Funds from the operations is equal to Rs. 7,000. Table 15.14 shows the funds flow statement and table 15.15 shows the funds from operation.

Table 15.14			
Funds Flow Statement			
Sources		uses	
Capital	5,000	Increase in WC	12,000
FFO	7,000		
	12,000		12,000

Funds from Operation	
Loss (difference in reserves)	-8,000
Add	
Depreciation	
Plant	10,000
Furniture	5,000
FFO	7,000

Or

Funds from Operation	
Closing Reserves	26,000
Add	
Depreciation	
Plant	5,000
Furniture	10,000
	41,000
Less Opening Reserves	34,000
FFO	7,000

Assumptions:

- Change in the capital has been treated as issue of capital in consideration of cash. So it is treated as source of fund.
- Change in reserves on the balance sheet will be treated as profit or loss during the year and distribution of dividend. Such profit or loss will be used to calculate the funds generated from the operations as follows:
- FFO can also be calculated as follows:
 - $FFO = \text{Closing Reserves} + (\text{Non cash expenses} + \text{Non-operating items} - \text{Non-operating incomes}) - \text{Opening Reserves}$.
- Or
 - $FFO = \text{Profit} + \text{Non cash expenses (depreciation, amortisation)} + \text{Non-operating expenses (interest on loan)} - \text{Non-operating incomes}$
- $FFO = -8000 + 15000 \text{ (depreciation on plant and furniture)} = \text{Rs. } 7000$

Now let us prepare the cash flow statement (CFS). CFS shows the cash inflows and cash outflows. In the above example cash has increased by 3000 from 16,000 to 19,000. Table 15.15 shows the cash flow statement. Cash can change due to the following:

- Cash from financing
- Cash from investment
- Cash from operations

Table 15.15

Cash Flow Statement	
Opening Cash	16,000
Cash From Financing	5,000
Cash from Investment	0
Cash From Operations	-2,000
Closing Cash	19,000

Cash From Operation	
profit	-8000
Add	
Depreciation	15000
Less	
Decrease in Current Liabilities	-9000
CFO	-2000

In this example

- Cash from financing is also equal to funds from financing
- There is no cash from investment and no funds from investment
- Cash from operation is different from the funds from operation due to the changes in the working capital.