



STUDY NOTE - 3

FINANCIAL ANALYSIS AND PLANNING

SECTION - 1

FUNDS FLOW ANALYSIS

This Section includes

- **Funds flow analysis**
- **Factors which affect Flow of Funds**
- **Purpose of funds flow analysis**
- **Converting Balance Sheet into Funds Flow Statement**
- **Sources of Funds**
- **Classification of Source of Funds**
- **Application of Funds**
- **Presentation of fund flow statement**
- **Sources of information for fund flow statement**
- **Funds flow analysis (summary)**

1.1 FUNDS FLOW ANALYSIS

- 1.1.1 Funds Flow analysis is carried out to examine whether Asset liability management is properly done with respect to both short term and long term funds.
- 1.1.2 This technique explains the changes between opening and closing values of assets and liabilities during a specified period of time.
- 1.1.3 The changes take place due to flow of funds as a result of transactions caused by various financial decisions. Some examples are given below:
 - a. Change in Asset value could be due to purchase of fresh assets or sale of assets or both.
 - b. Change in Debtors could be due to collection of cash or further sales to Debtors or both.

1.2 FACTORS WHICH AFFECT FLOW OF FUNDS

- 1. Financial Decisions
 - a. Sourcing (Financing)
 - b. Application (Investment)



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2. Performance of Business
 - a. Profit is an important source of fund earned through performance of business operations
 - b. Decline in Sales affects the internal generation adversely.
3. Accounting Policies:
 - a. Changes in Inventory Valuation

1.3 PURPOSE OF FUNDS FLOW ANALYSIS

- 1.3.1 The following questions are answered by funds flow analysis:
- a. Where from the funds came?
 - b. Where did the funds go?
 - c. How did the organisation finance its working capital?
 - d. How much funds were diverted from long term to short term and short term to long term?
 - e. Are projects undertaken in the previous years get additional funds?
 - f. Is there any change in the financial policy?
 - g. How much of operational efficiency contributing to capital needs of the company.

1.4 CONVERTING BALANCE SHEET INTO FUNDS FLOW STATEMENT

Sources	Application
Increase in Liabilities	Increase in assets
- Long-term	- Long-term
- Short-term	- Short-term
Decrease in assets	Decrease in Liabilities
- Long-term	- Long-term
- Short-term	- Short-term

1.5 SOURCES OF FUNDS

- 1.5.1 Sources of funds are given below:
- a. Increase in Equity
 - b. Increase in Debt
 - c. Increase in Reserves & Surplus
 - d. Decrease in Fixed Assets
 - e. Decrease in Debtors
 - f. Decrease in Inventory
 - g. Increase in Current Liabilities



1.6 CLASSIFICATION OF SOURCE OF FUNDS

- 1.6.1 The Sources can be classified as Internal Sources and External Sources.
- 1.6.2 Internal Sources constitute mainly the Profits of the organization or sale of assets or investments. Funds generated through internal sources are an indication of strength of an organization.
- 1.6.3 External source can be in the form of equity or debt. External debt source can be further classified in to long term and short term sources.

1.7 APPLICATION OF FUNDS

- 1.7.1 Funds generated and sourced can be applied the following ways:
 - a. Investment in fixed assets
 - b. Increase in debtors & other current assets
 - c. Repayment of long term debt
 - d. Decrease in current liabilities
 - e. Financing cash Loss in business operation
 - f. Payment of Dividend/Taxes

1.8 PRESENTATION OF FUND FLOW STATEMENT

- 1.8.1 Fund flow statement can be presented in the following three formats;
 - 1. Total resources basis
 - 2. Working capital basis(Impact on working capital)
 - 3. Cash basis(Impact on cash)

1.9 SOURCES OF INFORMATION FOR FUND FLOW STATEMENT

- a. Balance sheet (shows net effect)
- b. Balance Sheet and Profit and loss account (shows net effect plus some important flows like dividends)
- c. Balance sheet, Profit and loss account and schedules (shows much more of details)

1.10 FUNDS FLOW ANALYSIS (SUMMARY)

- 1. Flexible approach tailored to a situation
- 2. The Art of asking significant questions
- 3. Where shall we put our funds to best use in the interests of shareholders?
- 4. Where shall we able to get funds for taking advantage of opportunities?
- 5. Constant shifting of funds in sources and uses is what is happening in an organization



6. Changes in balance sheet captures the net effect
7. Selling on credit shifts funds from finished goods to debtors
8. Flow of funds help in appraising the impact of the management decision made during a certain period
9. Funds means shift in economic values

Illustration of funds statement:

	Year 1	Year 2	Change	Source	Application
Cash	231.00	245.70	14.70	0	14.7
Marketable securities	450.80	314.90	-135.90	135.9	0
Accounts receivable	807.10	843.50	36.40	0	36.4
Inventories	1170.70	1387.10	216.40	0	216.4
Total Current assets	2659.60	2791.20	131.60	0	
Gross Plant and equipment	11070.40	11897.70	827.30	0	827.3
Accumulated depreciation	6410.70	6618.50	207.80	207.8	
Net plant and equipment	4659.70	5279.20	619.50	0	
Investments	574.80	735.20	160.40	0	160.4
Other assets	260.90	362.30	101.40	0	101.4
Total Assets	8155.00	9167.90	1012.90	0	
Liabilities					
Notes payable	65.30	144.50	79.20	79.2	0
Accounts payable	571.20	622.80	51.60	51.6	0
Accrued taxes	346.30	275.00	-71.30	0	71.3
Short term debt	433.70	544.30	110.60	110.6	0
Current maturities	30.40	50.80	20.40	20.4	0
Total current liabilities	1446.90	1637.40	190.50		
Long term debt	1542.50	1959.90	417.40	417.4	0
Deferred taxes	288.40	405.30	116.90	116.9	0
Deferred credits	27.00	36.30	9.30	9.3	0
Total liabilities	3304.80	4038.90	734.10		0
Common stock	1627.70	1644.10	16.40	16.4	0
Share premium	2.80	27.70	24.90	24.9	0
Retained earnings	3219.70	3457.20	237.50	237.5	0
Total equity	4850.20	5129.00	278.80		0
Total	8155.00	9167.90	1012.90		0
				1427.9	1427.9

Sources of Funds	Amount	%
Decrease in Marketable Securities	135.9	10%
Depreciation	207.8	15%
Increase in		
Notes payable	79.2	6%
Accounts payable	51.6	4%
Short term debt	110.6	8%
Current maturities	20.4	1%
Long term debt	417.4	29%
Deferred taxes	116.9	8%
Deferred credits	9.3	1%
Common stock	16.4	1%
Share premium	24.9	2%
Retained earnings	237.5	17%
Total	1427.9	100%
Application of funds		
Increase in		
Cash	14.7	1%
Accounts receivable	36.4	3%
Inventories	216.4	15%
Plant and equipment	827.3	58%
Investments	160.4	11%
Other assets	101.4	7%
Decrease in		0%
Accrued taxes	71.3	5%
	1427.9	100%