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The Significance and Analysis of Funds Flow Statement in Business

1. Dr. Mahima Gupta 2. Dr. Lalit Mohan 3. Pankaj Nigam 4. Radhika Sharma 5. Kaushal Kumar Gehlot

1. Assistant Professor Department of ABST S.D.Govt. College Beawar Ajmer Rajasthan

2. Assistant Professor Department of ABST S.P.U. PG College Falna Pali Rajasthan

3. Assistant Professor (Guest Faculty) Department of ABST Govt.College Amet Rajsamand Rajasthan

4. Assistant Professor Faculty of Commerce Leela Devi Parashmal Sancheti Kanya Mahavidyalaya Vidyawadi Khimel Rani Pali Rajasthan

5. Assistant Professor (Guest Faculty) Department of Business Administration Govt. College Bali Pali Rajasthan

ABSTRACT

The main objectives of working capital management include maintaining the working capital operating cycle and ensuring its ordered operation, minimizing the cost of capital spent on the working capital, and maximizing the return on current asset investments. Working capital is a prevalent metric for the efficiency, liquidity and overall health of a company. It is a reflection of the results of various company activities, including revenue collection, debt management, inventory management and payments to suppliers. This is because it includes inventory, accounts payable and receivable, cash, portions of debt due within the period of a year and other short-term accounts.

Key Words : Object, Significance and Limitation

Backdrop

Fund flow statement is a statement prepared to analyse the reasons for changes in the financial position of a company between two balance sheets. It portrays the inflow and outflow of funds i.e. sources of funds and applications of funds for a particular period.

It is also righteous to say that a fund flow statement is prepared to explain the changes in the working capital position of a company.

A fund flow statement reveals the reasons for these changes or anomalies in the financial position of a company between two balance sheets. These statements portray the flow of funds - or the sources and applications of funds over a particular period.Why prepare a fund flow statement?

A company's financial statements already include a profit and loss statement and a balance sheet. a fund flow statement needed for-

A profit and loss and balance sheet will show a company's financial position, but will not explain the reasons for fluctuations or variations in within the company's financial or cash position

A profit and loss and balance sheet will depict two sets of figures - the current and previous year - but will not explain why movement has happened.The importance of fund flow statements

A funds flow statement is an essential factor in revealing how funds are used. A fund flow statement shows financial analysts how to assess the fund flow of an organization in the near future.

Usually, the preparation of these statements is followed by a funds flow statement analysis. It serves as a financial parameter that helps a company to control its finance and develop a better strategy for long term financial planning, and to utilize short term and long term funds.

Objectives of Fund Flow Statement

-Helps in knowing the changes in the company’s financial position : The main aim of preparing a fund flow statement is to cite the reasons for changes in the liabilities, assets, or equity capital. It is done by comparing the two balance sheets for different accounting periods.

-Analysing the operational position of the company : The balance sheet gives a static view of the company's financial position. It is only an overview of the current position of the company at any particular date so a thorough review of the movement of funds is essential for better financial planning.

-Helps in proper allocating of the resources : Fund flow statement helps in providing information regarding the allocating of the resources more efficiently and effectively. It also gives information regarding external and internal sources of financing.

-To evaluate the financial withstanding of the company : The external and internal users of the financial statement require fund flow statements to assess the company's strengths and weaknesses.

-Fund flow statement acts as a future guide : Fund flow statement reflects all details regarding the historical changes that have taken place in the company's working capital and net assets in a particular accounting period. This in turn serves as a guide to make financial decisions to achieve the goals of the organization.

Significance or Benefits of Funds Flow Statement.

The following are the uses, significance or benefits of funds flow statement.

-Fund Flow Statement is significant as it analyzes the adjustments in financial position of an organization featuring the sources and applications of its funds.

-It offers valuable information in regards to the company's working, funding and investing activities within a particular period. It is a crucial instrument employed in analyzing a firm's overall performance.

-This statement can be used by individuals when thinking about investing in a company. It displays problems an organization has if the cash flow is unfavorable.

-These statements are prepared as often as required. Small business owners prepare them on a regular basis, usually monthly, every quarter and yearly. Bigger companies usually prepare them more infrequently, typically quarterly and yearly.

-The financial resources of the company are analyzed in detail and disclose the changes made between the two balance sheet dates.

-It functions as a guide to the management to prepare its dividend, retention and investment policy, etc.

-It helps to assess the financial implications of business transactions associated with operational finance and investment.

-The cost of capital of the business can be computed on the basis of the sources of funds flow statement.

-It shows the usage of earned profits of the current year.

-The sources of previous year funds flow statement may act as a guide for getting funds for future requirements.

-Sometimes, the company has high liquid cash position even though, there is a net loss for the specific period. The reason for such position is find out through funds flow statement.

-The application of funds can provide a basis for selection of investment proposals or future capital expenditure decisions.

-The overall credit worthiness of the company can find out on seeing the funds flow statement.

-The strength and weakness of financial position of the company are identified on seeing the funds flow statement.

-It helps the management to allot the inadequate resources to meet the requirements of business at productive level.

-It helps the management to frame or change the financial policy of the company.

-It suggests ways to improve working capital position of the company.

-The information provided by a this statement is much more trustworthy, reliable & consistent because it is prepared to include funds generated from operations and not net profit after depreciation.

-It demonstrates the firms' capacity to generate long-term financing to meet the investment in long-term assets.

Not everyone's business will need to create a fund flow statement. Small businesses with limited assets that are not publicly held can forego the creation of a fund flow statement and use the other financial statements at their disposal.

Modern businesses v/s Fund Flow Statement

Given the importance of fund flow statements brings to the table, most of the businesses prepare and analyse this statement more frequently. Today, most businesses use ERP software or accounting software which automatically prepares the fund flow statement along with various other financial statements. This allows business owners and other users of financial information to analyse and make on-time smart business decisions.

Fund Flow Analysis

Fund flow analysis is used to understand changes in financial position. Similar to a cash flow statement, fund flow statement analysis uses financial statements such as a balance sheet or income statement in its analysis.

Most businesses use a combination of three main financial statements to analyze business finance and operations.

Balance sheet: A balance sheet provides a summary view of all asset, liability, and capital accounts and their current balances as of a specific period of time.

Profit and Loss/Income Statement: The profit and loss or income statement is used to summarize revenue, expenses, and profit or loss earned for a specific period of time.

Cash flow statement: Most similar to a fund flow statement, the cash flow statement measures cash inflow and outflow during a particular period of time by looking at the inflow of cash and cash outflow from operating activities, investing activities, and financing activities.

While a single balance sheet can provide details on current assets, liabilities, and equity, it’s impossible to determine where those funds came from or how they have been used.

One of the most useful things about fund flow analysis and a fund flow statement is how it looks at two different accounting periods, providing detailed information on the changes taking place between the current year and the previous year.While both are valuable to an organization, the cash flow statement is designed to address current and short-term cash flow and cash position, while the fund flow statement is much more useful for organizations looking to plan for the future.

The following formula to calculate working capital:

WC = Current assets – Current liabilities

Working capital measures a company's operation efficiency and short-term financial health. For example, positive working capital shows that a company has enough funds to meet its short-term liabilities. In comparison, negative working capital shows that a company has trouble in meeting its short-term liabilities with its current assets.

Limitations of the Fund Flow Statement

There are limitations to the fund flow statement, including its lack of originality. In its true form, the fund flow statement uses information from other financial statements that business owners already have access to, making the report redundant in some cases. Another issue is that it does not address the movement of cash such as fund inflows or outflow of funds from your business, concentrating only on fund origination and use. In a best-case scenario, a business would continue to utilize other financial statements such as a balance sheet, income statement, and cash flow statement to get a more nuanced view of the company's financial health.

Solid financial management requires more than a quick review of your balance sheet and income statement. By adding the fund flow statement and fund flow analysis to your financial planning process, you have quick access to your working capital positions along with a more in-depth look at business operations.

Conclusion

Working capital affects many aspects of your business, from paying your employees and vendors to keeping the lights on and planning for sustainable long-term growth. In short, working capital is the money available to meet your current, short-term obligations.Working capital is a daily necessity for businesses, as they require a regular amount of cash to make routine payments, cover unexpected costs, and purchase basic materials used in the production of goods.

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