

Funds Flow Analysis

Meaning:

Funds flow refers to change in fund. Increase of funds of any transaction is a source and decrease of funds in any transaction is application or uses of funds. Fund being working capital funds flow refers to the flow of working capital between two points of time. It involves information relating to the various changes undergone in working capital during a given period i.e. between the two balance sheet dates.

Every change in working capital is associated with a flow of funds i.e. either an inflow or an outflow of funds. Thus, funds flow involves information relating to the inflows and outflows of funds that resulted in a change in working capital between the two points of time.

Funds flow statement is a statement which shows the sources from which funds were obtained and the uses to which they have been put during a particular period. It speaks about the changes in financial items of balance sheets prepared at two different dates. Therefore, the funds flow analysis studies the movement of funds (inflows and outflows of funds) during a given period, generally a year. Thus it exhibits the movements of funds in both the directions – inside and outside the business. In other words, the term ‘flow’ in the context of funds flow analysis indicates the transfer of cash or cash equivalent from asset to equity or from one equity to equity or from one asset to another asset.

Significance of funds flow:

- It helps shareholders, creditors and others to evaluate the uses of funds by the enterprise.

- It assists in analysis of past trends and thus aid future expansion decisions.
- It helps finance managers in identification of problems, enabling detailed analysis and immediate action.

Uses of Funds Flow Statement:

- It guides the management in deciding about the dividend and retention policies.
- It enables planning for long-term purposes.
- It facilitates proper allocation of resources and funds.
- It indicates the sources from which the company has obtained its funds.
- It helps in ascertaining the factors resulting in changes in the working capital position of an enterprise.

Advantages of Funds Flow Statement:

Funds flow statement is prepared to show changes in the assets, liabilities and equity between two balance sheet dates, it is also called statement of sources and uses of funds. The advantages of preparing funds flow statement are:

- Funds flow statement reveals the net result of operations done by the company during the year.
- In addition to the balance sheet, it serves as an additional reference for many interested parties like creditors, suppliers, government etc. to look into financial position of the company.
- It shows how the funds were raised from various sources and also how those funds were put to use in the business, therefore it is a great tool for

management when it wants to know about where and from funds were raised and also how those funds got utilized into the business.

- It reveals the causes for the changes in liabilities and assets between the two balance sheet dates therefore providing a detailed analysis of the balance sheet of the company.
- Funds flow statement helps the management in deciding its future course of plans and also it acts as a control tool for the management.
- Funds flow statement should not be looked alone rather it should be used along with balance sheet in order judge the financial position of the company in a better way.
- **Limitations of Funds Flow Statement:**
- Though funds flow statement has many advantages it has also some disadvantages or limitations. The major limitations of funds flow statement are:
 - Funds flow statement has to be used along with balance sheet and profit and loss account, it cannot be used alone.
 - It does not reveal the cash position of the company, and that is why company has to prepare cash flow statement in addition to funds flow statement.
 - Funds flow statement merely rearranges the data which is there in the books of account and therefore it lacks originality. In simple words it

presents the data in the financial statements in systematic way and therefore many companies tend to avoid preparing funds flow statements.

- Funds flow statement is basically historic in nature, that is it indicates what happened in the past and it does not communicate anything about the future, only estimates can be made based on the past data and therefore it cannot be used the management for taking decision related to future.



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