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An importance of 'statement of changes in working capital' in fund-flow statement

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Abstract

As we know that the Fund Flow-Statement is a combination of two words; fund and flow. The 'Fund' in narrow sense, is a synonyms to cash, gives brief description of cash receipts and cash payment, but while in broad sense, is a working capital. Further, in detail, we can say that it is the difference of current assets and current liabilities.

Working Capital= Current Assets - Current Liabilities

Current Assets are those which can be converted into cash within an accounting year, are known as Current Assets. The following items are included; Cash, Cash in hand, Cash at bank, Stock, Bank, Bills Receivable, Prepaid Expenses and Debtor. On the other hand, for 'Current Liabilities', the companies top authority is advised to pay debt to external parties within a short-period of time. Further, it also includes some items like, Creditor, Bank Overdraft, Out Standing Expenses, Bills Payable, Provision for tax, Interim Dividend and Proposed Dividend.

Keywords: Working capital, fund-flow statement, current assets, current liabilities

Introduction

The following decisions are also part of 'Fund Flow-Statement'. From what sources finance has been provided for increase in working capital, From what sources cash has been obtained for payment of loan and redemption of debentures, In what manner, amount received from the sale of fixed assets has been utilized, How or in what manner fixed assets have been expanded, How dividend was distributed amongst shareholder despite losses, Why working capital is less even when net profits are more, How and where the amount of net profit has been utilized, What were the sources of receiving funds between two accounting periods and how they were utilized, How the amount received from issue of shares and debentures was utilized, and what was the result of assets which were procured by increasing the share capital.

Further, researcher has given importance of Fund Flow-Statement in following three parts; For 'Financial Management', 'Importance for Shareholders' and 'Advantages to Creditors'. For 'Financial Management', is helpful in financial analysis, making comparative study possible, deciding future planning, determining dividend policy, managing working capital, & borrowing operations, & in case of 'Importance for Shareholders', answers to some questions, Is their investment in organization secured, Whether dividend has been distributed from the profits generated or from other sources, Why organization is not paying dividend with higher rates despite earning sufficient profits or why it is not distributing dividends, What is the dependence of organization on external debts and What is the condition of working capital of an organization and last for creditors, they are able to generate information regarding whether organization will be able to repay their loans and interest or not and whether loan given by them is secured or not?

Fund Flow-Statement is prepared on the basis of fixed assets, long-term liabilities shown in balance sheets of two periods and changes taken place in capital fund. This statement is divided into two parts; 1. Sources of funds and 2. Uses of funds.

Difference between sources of funds and uses of funds depicts the changes taken place in net working capital which means.

Increase in Net Working Capital= Sources of funds-Uses/Application of funds.

Decrease in Net Working Capital= Uses/Application of funds- Sources of funds.

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The 'Sources of Fund' includes Funds from operation, Issue of share capital, Issue of debentures, Raising long-term loans, Sale of fixed assets & long-term investments, Increase in Long-Term Liabilities, Increase in Share Capital and Non-Trading Receipts. But while Uses of Fund includes Losses in business operation, Purchase of fixed assets, Payment of long-term liabilities, Decrease in capital fund and Payment of Non-Trading Liabilities.

Apart from this, following are the rules include in Schedule of Changes in Working Capital; Increase in current assets increases working capital, Decrease in current assets decreases working capital, Increase in current liabilities decreases working capital and Decrease in current liabilities increases working capital.

Calculation of funds from business operation:

A. Items which are to be added to net profit: Non fund items, Depreciation, Writing-off of fictitious and intangible assets, Non trading losses or charges and Appropriation of funds.

B. Items which are to be deducted from net profit: Interest and Dividend received on investments, Profits on sale of fixed assets, Increase in value of fixed assets and Transfer of excess provisions.

Review-Literatures

R.V. Berry 1969 ^[1], in their research paper titled 'Preparation and Presentation of Fund-Flow-Statement' has explained that this statement shows the changes in working capital and total amount of Sources & Application of funds from company's balance-sheet. The main purpose is to show

the present position of firm to share-holders. It helps them to take the decisions regarding investments in projects. According to researcher, this statement also shows the total receipts from debtor and total payment to creditors.

Miakiran Reddy 2007 ^[2], in her research paper titled 'Role of Fund-Flow-Statement' has explained that this statement gives information about the inflow and outflow of cash for during a particular period of time. It also helps managers to inform the 'availability of sources of cash', 'total volume of firms liabilities, assets, profits and losses' and changes that have taken place in firm's balance-sheet. In last, researcher concludes that this statement utilizes working-capital in proper functioning of firm's activities.

Need of the Study

Researchers in their studies have discussed about the use and purpose to make Fund-Flow Statement but they do not have given reason to make. Therefore, this is the purpose to write the research-paper.

Objectives

1. To know the purpose to make Fund-Flow-Statement.
2. To know, the reason to change in working capital.

Time-Period

To conduct fund flow statement for 2016 and 2017.

Data

The Secondary data would be used to achieve the objectives.

Analysis and Interpretation

Ratio	2016	2017	Change	Interpretation
Current ratio (2:1)	2.30	2.35	0.05	The calculated current ratio is more ideal ratio. Hence; there is efficiency in working capital.
Liquidity ratio (1:1)	4.49:1	5.01:1	4	The calculated liquidity ratio is more than ideal ratio. Hence; it indicates the good liquidity position.
Absolute liquid ratio (5:1)	0.89	0.49	-4	The calculated Absolute liquidity ratio is less than ideal ratio. Hence; it indicates the bad liquidity position.
Debt-equity ratio (1:1)	15.04	14.59	-0.45	The calculated Debt-Equity ratio is less than ideal ratio. Hence; it indicates the security of creditors.
Solvency ratio	0.35	0.34	-0.01	The total assets are more than total liabilities. Hence; it indicates that the Solvency position is good.
Proprietors fund	9.9	0.01	-9.89	This ratio is high. Hence; it indicates the sound position.
Ratio of F.A. to Proprietor's fund	0.75	0.46	-0.29	This ratio is high. Hence; it indicates the sound position.
Ratio of C.A. to Proprietor's fund	70.12	63.69	-6.43	This ratio is high. Hence; it indicates the sound position.
Ratio of C.A. to total liabilities	0.38	0.19	-0.19	This ratio is high. Hence; it indicates the sound position.
Capital gearing ratio	0.32	0.34	0.02	It is high gearing ratio. Hence; it indicates that fixed expenses have less bearing on profit.

Conclusion

In Secondary data based study, researchers have been identified the use and reason to change in working capital for study period. Apart from this, calculated the some ratios; Current Ratio, Liquidity Ratio, Absolute Liquid Ratio, Absolute Liquid Ratio, Solvency Ratio, Proprietors Ratio, Ratio of fixed assets to proprietors fund ratio, Ratio of current ratio to proprietor's fund, Ratio of current assets to total liabilities, and Capital Gearing Ratio. These have been resulted that the Current ratio is maximum (4) while proprietor's fund ratio is minimum (-9.89) and rest stand between 0 to 1.

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