Provision for taxation	*20,000*	*Cash Balance*	*30,000*
	3,00,000		*3,00,000*

Notes

Solution.

(*i*) Debt–Equity Ratio $= \dfrac{\text{Long – Term Debt}}{\text{Shareholders Fund}}$

Long-term Debt = Secured loan ₹ 80,000

Shareholder's Fund = Equity Share Capital + Reserves + P.L. A/c

= 1,00,000 + 20,000 + 30,000 = 1,50,000

Debt-Equity Ratio $= \dfrac{80,000}{1,50,000} = .53$

(*ii*) Liquidity Ratio $= \dfrac{\text{Liquid Assets}}{\text{Liquid Liabilities}}$

Liquid Assets = Sundry Debtors + Advances + Cash Balance

= 30,000 + 10,000 + 30,000 = 70,000

Liquid Liabilities = Provision for Taxation + sundry creditors

= 20,000 + 50,000 = 70,000

Liquid Ratio $= \dfrac{70,000}{70,000} = 1$

(*iii*) Fixed Assets to Current Assets

$= \dfrac{\text{Fixed Assets}}{\text{Current Assets}} = \dfrac{1,40,000}{1,00,000} = 1.4$

(*iv*) Fixed Assets Turnover $= \dfrac{\text{Turnover}}{\text{Fixed Assets}} = \dfrac{5,60,000}{1,40,000} = 4$

Illustration 4. *The Balance sheet of Naronath & Co. as on 31.12.2000 shows as follows :*

Liabilities	₹	*Assets*	₹
Equity capital	*1,00,000*	*Fixed Assets*	*1,80,000*
15% Preference shares	*50,000*	*Stores*	*25,000*
12% Debentures	*50,000*	*Debtors*	*55,000*
Retained Earnings	*20,000*	*Bills Receivable*	*3,000*
Creditors	*45,000*	*Bank*	*2,000*
	2,65,000		*2,65,000*

Comment on the Financial position of the Company i.e., Debt-Equity Ratio, Fixed Assets Ratio, Current Ratio, Liquidity.

Solution.

(*i*) Debt–Equity Ratio $= \dfrac{\text{Debt - Equity Ratio}}{\text{Long - Term Debt}}$

Long-term Debt = Debentures = 50,000

Shareholder's Fund = Equity Share Capital + Retained Earnings

= 1,00,000 + 50,000 + 20,000

$= \dfrac{50,000}{1,70,000} = .29$

Notes

(ii) Fixed Assets Ratio = $\frac{\text{Fixed Assets}}{\text{Proprietor's Fund}}$ = 1,80,000

Proprietor's Fund = Equity Share Capital + Preference Share Capital + Retained Earnings

= 1,00,000 + 50,000 + 20,000 = 1,70,000

Fixed Assets Ratio = $\frac{1,80,000}{1,70,000}$ = 1.05

(iii) Current Ratio = $\frac{\text{Current Assets}}{\text{Current Liabilities}}$

Current Assets = Stores + Debtors + BR + Bank

= 25,000 + 55,000 + 3,000 2,000 = 85,000

Current Liabilities = 45,000

Current Ratio = $\frac{85,000}{45,000}$ = 1.88

(iv) Liquid Ratio = $\frac{\text{Liquid Assets}}{\text{Liquid Liabilities}}$

Liquid Assets = Debtors + Bill Receivable + Cash

= 55,000 + 3,000 + 2,000 = 60.000

Liquid Liabilities = 45,000

Liquid Ratio = $\frac{60,000}{45,000}$ = 1.33

***Illustration 5.** From the following particulars pertaining to Assets and Liabilities of a company calculate :*

(a) Current Ratio *(b) Liquidity Ratio*

(c) Proprietary Ratio *(d) Debt-equity Ratio*

(e) Capital Gearing Ratio

Liabilities	₹	*Assets*	₹
5000 equity shares ₹ 10 each	*5,00,000*	*Land & Building*	*6,00,000*
8% 2000 per shares ₹ 100 each	*2,00,000*	*Plant & Machinery*	*5,00,000*
9% 4000 Debentures of ₹ 100 each	*4,00,000*	*Debtors*	*2,00,000*
Reserves	*3,00,000*	*Stock*	*2,40,000*
Creditors	*1,50.000*	*Cash and Bank*	*55,000*
Bank over draft	*50,000*	*Prepaid Expenses*	*5,000*
	16,00,000		*16,00,000*

Solution.

(i) Current Ratio = $\frac{\text{Current Assets}}{\text{Current Liabilities}}$

Current Assets = Stock + Cash + Prepaid Expenses + Debtors

= 2,40,000 + 55.000 + 5,000 + 2,00,000

= 5,00,000

Current Liabilities = Creditors + Bank Overdraft

Notes

$$= 1,50,000 + 50,000 = 2,00,000$$

$$= \frac{5,00,000}{2,00,000} = 2.5 : 1$$

(*ii*) $$\text{Liquid Ratio} = \frac{\text{Liquid Assets}}{\text{Liquid Liabilities}}$$

$$\text{Liquid Assets} = \text{Cash and Bank} + \text{Debtors}$$

$$= 55,000 + 2,00,000 = 2,55,000$$

Liquid Liabilities: Creditors

$$= 1,50,000$$

$$\text{Liquid Ratio} = \frac{2,55,000}{1,50,000} = 1.7 : 1$$

(*iii*) $$\text{Proprietary Ratio} = \frac{\text{Proprictor's Fund}}{\text{Total Tangible Assets}}$$

$$\text{Proprietor's Funds} = \text{Equity Share Capital} + \text{Preference Share Capital} + \text{Reserves and Surplus}$$

$$= 5,00,000 + 2,00,000 + 3,00,000$$

$$\text{Proprietary Ratio} = \frac{10,00,000}{16,00,000} = 0.625 : 1$$

(*iv*) $$\text{Debt-Equity Ratio} = \frac{\text{External Equities}}{\text{Internal Equities}}$$

$$\text{External Equities} = \text{Long-term Liabilities} + \text{Short-term Liabilities}$$

$$= 4,00,000 + 2,00,000 = 6,00,000$$

$$\text{Internal Equities} = \text{Proprietor's funds}$$

$$= \frac{6,00,000}{10,00,000} = 0.6 : 1$$

(*iv*) $$\text{Capital Gearing Ratio} = \frac{\text{Fixed Interest Bearing Securities}}{\text{Equity Share Capital} + \text{Reserves}}$$

Fixed Interest Bearing Securities	= Preference Shares	2,00,000
	= Debentures	4,00,000
		6,00,000

$$= \frac{6,00,000}{8,00,000} = 0.75 : 1$$

Illustration 6. *From the following details of a trader you are required to calculate :*

(*i*) *Purchase for the year* (*ii*) *Rate of stock turnover*

(*c*) *Percentage of Gross profit to turnover*

Sales ₹	*33,984*	*Stock at the close at cost price*	*1,814*
Sales Returns	*380*	*G.P. for the year*	*8068*
Stock at the beginning at cost price	*1,378*		

Notes

Solution. **Trading Account**

To Opening stock	1,378	By Sales	33,984
To Purchase (Bf)	25,972	(–) Sales Returns	380
To gross profit	8,068		33,604
		By Closing stock	1,814
	35,418		35,418

(*i*) Purchase for the year ₹ 25,972

(*ii*)
$$\text{Stock Turnover} = \frac{\text{Cost of Goods Sold}}{\text{Average Stock}}$$

$$\text{Cost of Goods Sold} = \text{Sales} - \text{GP} = 33{,}984 - 8{,}068 = 25{,}916$$

$$\text{Average Stock} = \frac{\text{Opening Stock} + \text{Clo sin g Stock}}{2}$$

$$= \frac{1{,}372 + 1{,}814}{2} = 1{,}596$$

$$= \frac{25{,}916}{1{,}596} = 16.23 \text{ times}$$

(*iii*) Percentage of Gross Profit to Turnover

$$= \frac{\text{GP}}{\text{Sales}} \times 100 = \frac{8{,}068}{33{,}984} \times 100 = 23.74\%$$

Problem 7. *Calculate stock turnover ratio from the following information :*

Opening Stock	*58,000*
Purchases	*4,84,000*
Sales	*6,40,000*
Gross Profit Rate - 25% on Sales	

Solution.

(*i*)
$$\text{Stock Turnover Ratio} = \frac{\text{Cost of Goods Sold}}{\text{Average Stock}}$$

$$\text{Cost of Goods Sold} = \text{Sales} - \text{GP}$$

$$= 6{,}40{,}000 - 1{,}60{,}000 = 4{,}80{,}000$$

$$\text{Stock Turnover Ratio} = \frac{4{,}80{,}000}{58{,}000} = 8.27 \text{ times } \textbf{Ans.}$$

Here, there is no closing stock. So, there is no need to calculate the average stock.

Illustration 8. *Calculate the operating Ratio from the following figures.*

Items	*(₹ in Lakhs)*
Sales	*17,874*
Sales Returns	*4*
Other Incomes	*53*
Cost of Sales	*15,440*

Administration and Selling Exp.	*1,843*
Depreciation	*63*
Interest Expenses (Non-operating)	

Notes

Solution.

$$\text{Operating Ratio} = \frac{\text{Cost of Goods Sold} \div \text{Operating Expenses}}{\text{Sales}} \times 100$$

$$= \frac{15,440 + 1,843}{17,870} \times 100 = 97\%$$

Illustration 9. *The following is the Trading and Profit and loss account of Mathan Bros Private Limited for the year ended June 30,2001.*

		₹			₹
To Stock in hand		*76,250*	*By sales*		*5,00,000*
To Purchases		*3,15,250*	*By Stock in hand*		*98,500*
To Carriage and Freight		*2,000*			
To Wages		*5,000*			
To Gross Profit		*2,00,000*			
		5,98,500			*5,98,500*
To Administration					
Expenses		*1,01,000*	*By Gross profit*		*2,00,000*
To Finance Expenses :			*By Non-operating Incomes*		
Interest	*1,200*		*Interest on Securities*	*1,500*	
Discount	*2,400*		*Dividend on Shares*	*3,750*	
Bad Debts	*3,400*	*7,000*	*Profit on Sale of Shares*	*750*	*6,000*
To Selling Distribution Expenses		*12,000*			
To Non-operating expenses					
Loss on sale of securities	*350*				
Provision for legal suit	*1,650*	*2,000*			
To Net profit		*84,000*			
		2,06,000			*2,06,000*

You are required to calculate:

(*i*) *Gross profit Ratio*	(*ii*) *Expenses Ratio (individual)*
(*iii*) *Net profit Ratio*	(*iv*) *Operating profit Ratio*
(*v*) *Operating Ratio*	(*vi*) *Stock turnover Ratio*

Solution.

(*i*) $$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100 = \frac{2,00,000}{5,00,000} \times 100$$

(*ii*) $$\text{Expenses Ratio} = \frac{\text{Individual Expenses}}{\text{Sales}}$$

(*a*) $$\frac{\text{Ad min istration Epenses}}{\text{Sales}} \times 100 = \frac{1,01,000}{5,00,000} \times 100 = 2.02\%$$

(*b*) $$\frac{\text{Finance Expenses}}{\text{Sales}} \times 100 = \frac{7,000}{5,00,000} \times 100 = 1.40\%$$

(c) $\dfrac{\text{Selling and Distribution Expenses}}{\text{Sales}} \times 100$

$$= \frac{12,000}{5,00,000} \times 100 = 2.40\%$$

Notes

(d) $\dfrac{\text{Non - Operating Expenses}}{\text{Sales}} \times 100 = \dfrac{2,000}{5,00,000} \times 100 = 0.4\%$

(iii) *Net Profit Ratio :*

$$\frac{\text{Net Profit}}{\text{Sales}} \times 100 = \frac{84,000}{5,00,000} \times 100 = 16.8\%$$

(iv) Operating Profit Ratio $= \dfrac{\text{Operating Profit}}{\text{Sales}} \times 100$

Operating Profit = Net Profit + Non-Operating Expenses – Non Operating Incomes

$= 84,000 + 2,000 - 6,000 = 80,000$

$$= \frac{80,000}{50,00,000} \times 100 = 16\%$$

(v) Operating Ratio

$$= \frac{\text{Cost of Goods Sold + Operating Expenses}}{\text{Sales}} \times 100$$

Cost of Goods Sold = Sales – Gross profit

i.e., 5,00,000 – 2,00,000 = 3,00,000

Operating Expenses

All Expenses Debited in the Profit & Loss A/c Except Non-operating Expenses [including Finance expense]

1,01,000 + 7,000 + 12,000 = 1,20,000

Operating Ratio $= \dfrac{3,00,000 + 1,20,000}{5,00,000} \times 84\%$

(vi) Stock Turnover Ratio $= \dfrac{\text{Cost of Goods Sold}}{\text{Average Stock}}$

Cost of Goods Sold = 3,00,000

Average Stock $= \dfrac{\text{Opening Stock + Clo sin g Stock}}{2}$

$$= \frac{76,250 + 95,500}{2} = 85,875$$

$$= \frac{3,00,000}{85,875} = 3.49 \text{ times}$$

Problem 10. *Suraj & Co. sells goods on cash as well as credit (though not on deferred instalment terms). The following particulars are extracted from their books of account for the calendar year 2004.*

Total Gross sales	=	1,00,000
Cash sales (included in above)	=	20,000
Sales Returns	=	7,000
Total Debtors for Sales on 31.12.2004	=	9,000
Bills Receivable on 31.12.2004	=	1,000

Provision for Doubtful Debts on 31.12.2004 = 1,000

Total Creditors 31.12.2004 = 10,000

Calculate the Average Collection Period.

Solution.

Notes

Average Collection Period

$$= \frac{\text{Debtors + Bills Receivable + Provision for Doubtful Debts}}{\text{Net Credit Sales}} \times 365$$

$$= \frac{9,000 + 1,000 + 1,000}{73,000} \times 365 = 55 \text{ days}$$

Workings:

Net Credit Sales = Total Gross Sales – Cash Sales – Sales Returns

= 1,00,000 – 20,000 – 7,000 = 73,000

Illustration 11. *The following is the Trading account of M/s SKC Ltd. You are required to calculate the stock turnover Ratio.*

To Opening Stock	*7,960*	*By Sales*	*39,000*
To Purchases	*19,500*	*By Closing Stock*	*7,200*
To Carriage inwards	*500*		
To gross profit	*18,240*		
	46,200		*46,200*

Solution.

$$\text{Stock Turnover Ratio} = \frac{\text{Cost of Goods Sold}}{\text{Average Stock}}$$

$$\text{Cost of Goods Sold} = \text{Sales} - \text{Gross Profit}$$

$$= 39,000 - 18,240 = 20,760$$

$$\text{Average Stock} = \frac{\text{Opening Stock} + \text{Closing Stock}}{2}$$

$$= \frac{7,960 + 7,200}{2}$$

$$= 7,580$$

$$= \frac{20,760}{7,580} = 2.73 \text{ times}$$

Illustration 12. *The Balance Sheet of Lal and Co. on 31.12.2000 shows the following details :*

	₹
Cash	*9,500*
Marketable Securities	*15,000*
Inventories	*1,00,000*
Debtors	*85,000*
Prepaid Expenses	*5,000*
Long-term Loans	*1,06,000*
Trade Creditors	*64,000*

Income Tax Payable	*9,000*
Accrued Expenses	*12,000*

You are required to compute

(i) Current Ratio *(ii) Acid-Test Ratio.*

Notes

Solution.

(*i*) $$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\text{Current Assets} = \text{Cash + Marketable Securities + Debtors + Prepaid Expenses}$$
$$= 9{,}500 + 15{,}000 + 1{,}00{,}000 + 85{,}000 + 5{,}000$$
$$= 2{,}14{,}500$$

$$\text{Current Liabilities} = \text{Trade Creditors + Income Tax Payable + Accrued Expenses}$$
$$= 64{,}000 + 9{,}000 + 12{,}000 = 85{,}000$$

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\therefore \quad \frac{2{,}14{,}500}{85{,}000} = 2.52 : 1$$

(*ii*) $$\text{Acid Test Ratio} = \frac{\text{Liquid Assets}}{\text{Liquid Liabilities}}$$

$$\text{Liquid Assets} = \text{Cash + Marketable Securities + Debtors + Prepaid Expenses}$$
$$= 9{,}500 + 15{,}000 + 85{,}000 + 5{,}000 = 1{,}14{,}500$$

$$\text{Liquid Liabilities} = \text{Trade Creditors + Income Tax Payable + Accrued Expenses}$$
$$= 64{,}000 + 9{,}000 + 12{,}000 = 85{,}000$$

$$\therefore \quad \frac{1{,}14{,}500}{85{,}000} = 1.34 : 1$$

Illustration 13. *From the following figures calculate the creditors turnover ratio and the average age of accounts payable.*

	₹
Credit Purchase During the year 1998	*1,00,000*
Creditors on 01.01.1998	*20,000*
Creditors on 31.12.1998	*10,000*
Bills Payable on 01.01.1998	*4,000*
Bills Payable on 31.12.1998	*6,000*

Solution.

$$\text{Creditor's Turnover Ratio} = \frac{\text{Net Credit Purchase}}{\text{Average Account Payable}} = \frac{1{,}00{,}000}{20{,}000}$$
$$= 5 \text{ times}$$

$$\text{Average Payment Period} = \frac{\text{Months}}{\text{Creditors Turnover}} = \frac{12}{5} = 2.4 \text{ months}$$

Problem 14. *From the data given below compute :*

(*a*) *Working Capital* (*b*) *Net Capital Employed*

(*c*) *Current Ratio* (*d*) *Acid Test Ratio*

(*e*) *Debt-Equity Ratio* (*f*) *Fixed Assets Ratio*

Balance Sheet of Butterfly Ltd. as on 31st December

Liabilities	₹	Assets	₹
Equity Share Capital	*25,000*	*Fixed Assets*	*30,000*
Preference Share Capital	*5,000*	*Current Assets : Stores*	*2,000*
Reserve and Surplus	*4,000*	*Sundry Debtors*	*1,000*
Debentures	*8,000*	*Cash*	*500*
Bank loan	*4,000*	*Bank*	*2,500*
Sundry creditors	*1,000*	*Preliminary expenses*	*8,000*
Proposed Dividends	*1,000*	*Brokerage on shares*	*2,000*
Provision for Taxation	*2,000*	*Stock*	*4,000*
	50,000		*50,000*

Solution

Working Capital = Current Assets – Current Liabilities

Current Assets = Stores + Sundry Debtors + Cash + Bank + Stock

= 2,000 + 1,000 + 2,500 + 4,000 + 500 = 10,000

Current Liabilities = Sundry Creditors + Proposed Dividends + Provision for Taxation

= 1,000 1,000 + 2,000 = 4,000

(*a*) Working Capital = 1,000 – 4,000 = 6,000

(*b*) Net Capital Employed

All assets excluding fictitious assets – Current liabilities *i.e.,*

₹ 40,000 – 4,000 = 36,000

(*c*) $$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{10,000}{4,000} = 2.5 : 1$$

(*d*) $$\text{Acid Test Ratio} = \frac{\text{Liquid Assets}}{\text{Liquid Liabilities}}$$

Liquid Assets = 2,500 + 500 + 1,000 = *i.e.,* 4,000

Liquid Liabilities = 2,000 + 1,000 + 1,000 = *i.e.,* 4,000

$$= \frac{4,000}{4,000} = 1$$

(*e*) $$\text{Debt–Equity Ratio} = \frac{\text{Outsider's Fund}}{\text{Shareholder's Fund}} = \frac{16,000}{34,000} = .47 : 1$$

Outsider's Fund 16,000

Outsider's Fund = Debentures + Bank Loan + Sundry Creditors + Proposed Dividends + Provision for Taxation

= 8,000 + 4,000 + 1,000 + 1,000 + 2,000 = 16,000

Shareholder's Fund = Equity Share Capital + Preference Share Capital + Reserves and Surplus

= 25,000 + 5,000 + 4,000 = 34,000

Debt-Equity Ratio = 0.47 : 1

Notes

(*f*) Fixed Assets Ratio = $\frac{\text{Fixed Assets}}{\text{Long - term Funds}} = \frac{30,000}{46,000} = .65 : 1$

Long-term Funds = Equity Share Capital, Preference Share Capital, Reserves and Surplus, Debentures, Bank Loan.

= 25,000 + 5,000 + 4,000 + 8,000 + 4,000 = 46,000

Illustration. You have been asked by the management of a firm to project a Trading, Profit and Loss A/c and the Balance Sheet on the basis of the following estimated figures and ratios, for the next financial year.

Ratio to gross profit	*20%*
Stock turnover ratio	*5 times*
Average debt collection period	*3 Months*
Creditors	*3 Months*
Current ratio	*2*
Proprietary ratio (fixed assets to capital employed)	*75%*
Capital gearing ratio (Preference shares and debentures to equity)	*30%*
Net profit to issued equity capital	*10%*
General Reserve and Profit and Loss to issued equity capital	*25%*
Preference share capital to debentures	*2*
Cost of sales consists of 50% for materials	
Gross profit	*₹ 6,25,000*

Solution : Projected Trading and Profit Loss Account

Liabilities	Amount ₹	Incomes	Amount ₹
To Cost of materials	*12,50,000*	*By Sales*	*31,25,000*
To Direct expenses	*12,50,000*		
To Gross profit	*6,25,000*		
	31,25,000		*31,25,000*
To Indirect expenses	*4,81,500*	*By Gross profit*	*6,25,000*
(Balancing figure)			
To Net Profit	*1,43,5000*		
	6,25,000		*6,25,000*

Projected Balance Sheet

Preference Share Capital	5,12,500	Fixed Assets	19,21,875
Equity Share Capital	14,35,000	Current Assets :	
Debentures	2,56,250	Stock	5,00,000
General Reserve	2,15,250	Debtors	7,81,250
Profit and Loss A/c	1,43,500		
Current Liabilities:			
Overdraft	3,28,125		
Creditors	3,12,500		
	32,03,125		32,03,125

Workings :

1. **Sales :**

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$(i.e.)\ 20 = \frac{₹\,6,25,000}{\text{Sales}} \times 100$$

$$20 \text{ Sales} = ₹\,6,25,000 \times 100$$

$$\text{Sales} = \frac{`6,25,000}{20} \times 100$$

$$= \mathbf{₹\,31,25,00}$$

2. **Cost of Sales :**

$$\text{Cost of Sales} = \text{Sales} - \text{Gross Profit}$$

$$= ₹\,31,25,000 - ₹\,6,25,000$$

$$= \mathbf{₹\,25,00,000}$$

3. **Materials :**

$$50\% \text{ of Cost of Sales} = 50\% \text{ of } ₹\,25,00,000$$

$$= \mathbf{₹\,12,50,000}$$

4. **Direct Expenses :**

$$\text{Direct Expenses} = \text{Cost of Sales} - \text{Cost of Materials}$$

$$= ₹\,25,00,000 - ₹\,12,50,000$$

$$= \mathbf{₹\,12,50,000}$$

5. **Stock :**

$$\text{Stock Turnover Ratio} = \frac{\text{Cost of Sales}}{\text{Stock}} = 5$$

$$i.e.\ 5 = \frac{₹\,25,00,000}{\text{Stock}}$$

$$\textbf{Stock} = \mathbf{₹\,5,00,000\ (25,00,000/5)}$$

6. **Debtors :**

$$\text{Debtors Turnover} = \frac{\text{Debtors}}{\text{Credit Sales}} \times 12$$

Notes

$$(i.e.)\ 3 = \frac{\text{Debtors}}{₹\ 31,25,000} \times 12$$

Debtors = **₹ 7,81,250**

7. **Total Current Assets** = Stock + Debtors

= ₹ 5,00,000 + ₹ 7,81,250

= **₹ 12,81,250**

8. **Current Liabilities :**

$$= \frac{\text{Current Assets}}{\text{Current Liabilities}} = 2$$

(i.e.) 2 Current Liabilities = Current Assets

$$\text{Current Liabilities} = \frac{₹\ 12,81,250}{2}$$

= ₹ 6,40,625

9. **Creditors :**

$$\text{Creditors Turnover Ratio} = \frac{\text{Creditors}}{\text{Credit Purchases}} \times 12 = 3$$

$$(i.e.)\ 3 = \frac{\text{Creditors}}{₹\ 12,50,000} \times 12$$

Creditors = **₹ 3,12,500**

(Materials have been purchased on credit)

10. **Overdraft :**

Overdraft = Current Liabilities – Creditors

= ₹ 6,40,625 – ₹ 3,12,500

= ₹ 3,28,125

11. **Fixed Assets :**

$$\frac{\text{Fixed Assets}}{\text{Capital Employed}} = \frac{75}{100}$$

$$\frac{\text{Working Capital}}{\text{Capital Employed}} = \frac{25}{100}$$

Working Capital = Current Assets – Current Liabilities

= ₹ 12,81,250 – ₹ 6,40,625

= **₹ 6,40,625**

Fixed Assets = ₹ 6,40,625 × 3

= **₹ 19,21,875**

12. **Capital Employed :**

Capital Employed = Fixed Assets + Current Assets – Current Liabilities

= ₹ 19,21,875 + ₹ 12,81,250 – ₹ 6,40,625

= ₹ 25,62,500

13. Capital Gearing Ratio :

$$= \frac{\text{Pref. Share Capital + Debenture}}{\text{Total Capital Employed}} = 30\%$$

Pref. Share Capital + Debentures = 30% of ₹ 25,62,500

= **₹ 7,68,750**

Notes

Equity Shareholder's Fund = Capital Fund – (Pref. Share Capital and Debentures)

= ₹ 25,62,500 – ₹ 7,68,750

= **₹ 17,93,750**

Preference Share Capital = $₹ 7,68,750 \times \frac{2}{3}$ = **₹ 5,12,500**

Debentures = $₹ 7,68,750 \times \frac{1}{3}$ = **₹ 2,56,250**

14. General Reserve and Profit and Loss :

25% of Equity Share Capital = $₹ 17,93,750 \times \frac{25}{125}$ = ₹ 3,58,750

(Shareholders Fund include General Reserve and Profit)

15. Equity Share Capital :

Equity Shareholders Fund – (Reserve and Profit)

₹ 17,93,750 – ₹ 3,58,750 = **₹ 14,35,000**

16. Profit :

10% of Equity Share Capital

10% of ₹ 14,35,000 = **₹ 1,43,500**

17. General Reserve :

General Reserve and Profit – Profit

₹ 3,58,750 – ₹ 1,43,500 = **₹ 2,15,250**

Type II : Ratio to Balance Sheet

Illustration 1. *From the following details find out*

(*i*) *Current Assets*	(*ii*) *Current Liabilities*
(*iii*) *Liquid Assets*	(*iv*) *Stock*

Current Ratio	*2.5*
Liquidity Ratio	*1.5*
Working Capital	*₹ 60,000*

Solution. :

1	Current Assets	–	Current Liabilities	=	Working Capital
	↓		↓		↓
	2.5	–	1.0	=	1.5
	↓		↓		↓
	1,00,000	–	40,000	=	60,000
2	Liquid Ratio	:	Liquid Assets	:	Liquid Liabilities
			↓		↓
			1.5	=	1.00
			↓		↓
			60,000	=	40,000

Notes

	₹
Current Assets	1,00,000
Current Liabilities	40,000
Liquid Assets	60,000
Stock	40,000

NOTE :

(*i*) Here, all Current Liabilities have been taken as Liquid Liabilities

(*ii*) Difference between Current Assets and Liquid Assets is the stock.

Illustration 2. *From the following details, prepare Balance sheet of Moorthy Ltd., with as many details as possible.*

(*i*) *Stock Velocity : 6.*

(*ii*) *Capital Turnover Ratio : 2.*

(*iii*) *Fixed Asset Turnover Ratio : 4.*

(*iv*) *Gross Profit Turnover Ratio : 20%.*

(*v*) *Debtor's Velocity : 2 months.*

(*vi*) *Creditors Velocity : 73 days.*

(*vii*) *Gross Profit was ₹ 60,000.*

(*viii*) *Reserves and Surplus ₹ 20,000.*

(*ix*) *Closing Stock was ₹ 5,000 in Excess of Opening Stock.*

Solution.

Workings :

(*i*)

Cost of Goods Sold	+	GP	=	Sales
↓		↓		↓
80%		20%		100%
2,40,000	+	60,000	=	3,00,000

(*ii*)

$$\text{Stock turnover} = \frac{\text{Cost of Goods Sold}}{\text{Average Stock (X)}}$$

$$= \text{Stock Velocity (6)}$$

$$X = \frac{2,40,000}{6}$$

Average Stock = 40,000

Total Stock value = 40,000 × 2 = 80,000

Less : Excess = 5,000

75,000

Opening Stock = 37,500

Closing Stock = 37,500 + 5,000 = 42,500

(*iii*) Debtor's Velocity = 2 months

$$\frac{\text{Debtors (X)}}{\text{Sales}} \times 12 = 2\text{, i.e., } X = 3{,}00{,}000 \times \frac{2}{12}$$

$$\text{Debtors} = ₹\ 50{,}000$$

(iv) $$\text{Creditor's Velocity} = 73 \text{ days.}$$

$$\frac{\text{Creditors (X)}}{\text{Purchase}} \times 365 = 73$$

$$X = 2{,}45{,}000 \times \frac{73}{365} = 49{,}000$$

NOTE : Purchase = Cost of Sales + Increase in Stock = 2,40,000 + 5,000 = 2,45,000

(v) $$\text{Fixed Assets Turnover Ratio} = \frac{\text{Turnover}}{\text{Fixed Assets (X)}}$$

$$X = \frac{2{,}40{,}000}{4} = 60{,}000$$

(vi) $$\text{Capital Turnover Ratio} = 2$$

$$\frac{\text{Turnover}}{\text{Capital (X)}} = 2$$

$$X = \frac{2{,}40{,}000}{2} = 2 \qquad 1{,}20{,}000$$

(vii)	Total Capital	=	1,20,000
	Creditors	=	49,000
	Total Liabilities	=	1,69,000
	All Assets (42,500 + 50,000 + 60,000)	=	1,52,500
	Cash (1,69,000 – 1,52,500)	=	16,500
			1,69,000

Statement of Proprietary Funds :

Fixed Assets		=	60,000
Working Capital			
(Current Assets – CL)			
Closing Stock	42,500		
Debtors	50,000		
Cash	16,500		
	1,09,000		
Less : Creditors	49,000		
			60,000
Proprietor's Fund			1,20,000

It consists of share capital and Reserves and Surplus.

Share Capital	1,00,000
Reserves and Surplus	20,000
	1,20,000

Illustration 3. *Calculate the current assets of a company from the following information :*

Notes

(*i*) *Stock Turnover 5 times*

(*ii*) *Stock at the end is ₹ 5,000; more than the stock in the beginning*

(*iii*) *Sales (all credit) ₹ 2,00.000*

(*iv*) *Gross Profit Ratio 20%*

(*v*) *Current Liabilities ₹ 60,000*

(*vi*) *Quick Ratio 0.75.*

Solution. :

1. Cost of Goods Sold + GP = Sales

Cost of Goods Sold	+	GP	=	Sales
↓		↓		↓
80%	+	20%	=	100%
↓		↓		↓
1,60,000	+	40,000	=	2,00,000

2. Stock Turnover Ratio = 5 times

$$\frac{\text{Cost of Goods Sold}}{\text{Average Stock (X)}} = 5 \text{ times}$$

$$X = \frac{1,60,000}{5} = 32,000$$

Average Stock = ₹ 32,000

Full Stock Value = 32,000 × 2 = 64,000

Less : Excess Value = 5,000

59,000

$$\frac{59,000}{2} = 29,500$$

Opening Stock = 29,500

Closing Stock = 29,500 + 5,000 = 34,000

3. Quick Ratio

Quick Assets	:	Quick Liabilities
↓		↓
0.75	:	1.00
↓		↓
45,000	:	60,000

Quick Ratio

Closing Stock = 34,500

Quick Assets = 45,000

79,500

Illustration 4. *From the following information, prepare a Balance sheet as on 31.3.2003 :*

(*i*) *Working Capital ₹ 1,20,000*

(*ii*) *Reserves and Surplus 80,000*

(iii) Bank Overdraft 20,000 (vi) Current Ratio 2.5.

(iv) Assets (Fixed) – Proprietary Ratio 0.75 : 1

(v) Liquid Ratio 1.5

Solution. :

1. Current Assets	–	Current Liabilities	=	Working Capital
↓		↓		↓
2.5	–	1.00	=	1.5
↓		↓		↓
2,00,000	–	80,000	=	1,20,000

2. Proprietor's Fund	–	Fixed Assets	=	Working Capital
↓		↓		↓
1.00	–	.75	=	.25
↓		↓		↓
4,80,00	–	3,60,000	=	1,20,000

3. Liquid Ratio

Liquid Assets	:	Liquid Liabilities
1.5	:	1.00
90,000	:	60,000

Current Liabilities	80,000	Current Assets	2,00,000
Less : BOD	20,000	Liquid Assets	90,000
Liquid Liabilities	60,000	Stock	1,10,000

Balance Sheet

Liabilities	₹	Assets	₹
Share Capital (4,8,000 – 80,000)	4,00,000	Fixed Assets	3,60,000
Reserves and Surplus	80,000	Stock	1,10,000
Bank Overdraft	20,000	Other Current Assets	90,000
Sundry Creditors	60,000		
	5,60,000		5,60,000

Illustration 5. *From the following information prepare a Balance sheet and show the working.*

(i) Working Capital ₹ 75,000 (v) Liquid Ratio : 1.15

(ii) Reserves and Surplus ₹ 1,00,000 (vi) Long-term Liabilities Nil

(iii) Bank Overdraft ₹ 60,000 (vii) Fixed Assets to Proprietor's Fund : 0.75

(iv) Current Ratio : 1.75.

Notes

Solution. :

1. Current Assets	–	Current Liabilities	=	Working Capital
1.75	–	1.00	=	.75
↓		↓		↓
1,75,000	–	1,00,000	=	75,000

2. Proprietor's Fund	–	Fixed Assets	=	Working Capital
↓		↓		↓
1.00	–	.75	=	.25
↓		↓		↓
3,00,000	–	2,25,000	=	75,000

3. Liquid Ratio

Liquid Assets	:	Liquid Liabilities
1.15	:	1.00
↓		↓
46,000	–	40,000

Current Liabilities	1,00,000	Current Assets	1,75,000
Less : BOD	60,000	Liquid Assets	46,000
Liquid Liabilities	40,000	Stock	1,29,000

Balance Sheet

Liabilities	₹	Assets	₹
Share Capital (3,00,000 – 1,00,000)	2,00,000	Fixed Assets	2,25,000
Reserves and Surplus	1,00,000	Stock	1,29,000
Bank Overdraft	60,000	Other Current Assets	46,000
Sundry Creditors (1,00,000 – 60,000)	40,000		
	4,00,000		4,00,000

Illustration 6. *From the following particulars prepare the balance sheet of ABC Limited.*

(*i*) *Sales for the year ₹ 20,00,000*

(*ii*) *Gross Profit Ratio 25%*

(*iii*) *Current Ratio : 1.50*

(*iv*) *Quick (cash Drs) Ratio : 1.25*

(*v*) *Stock Turnover Ratio : 15*

(*vi*) *Debt Collection Period : 1 ½ months*

(*vii*) *Turnover to Fixed Assets : 1.5*

(*viii*) *Fixed Assets to Networth : 5/6 (.83)*

(*ix*) *Ratio of Reserves to Share Capital 1/3 (0.33) [The term turnover refers to cost of sales and stock refers to closing stock].*

Notes

Solution. :

(*i*) Cost of Goods Sold + GP = Sales

↓ ↓ ↓

75% + 25% = 100%

↓ ↓ ↓

1,50,000 + 5,00,000 = 20,00,000

(*ii*) Stock Turnover Ratio

$$\frac{\text{Cost of Goods Sold}}{\text{Average Stock (X)}} = 15 \qquad \frac{15,00,000}{X} = 15$$

$$X = \frac{15,00,000}{X}$$

$$\text{Average Stock} = 1,00,000$$

(*iii*) Current Ratio	:	1.50	6,00,000
Quick Ratio	:	1.25	5,00,000
Stock		.25	1,00,000

(*iv*) Current Ratio

Current Assets : Current Liabilities

↓ ↓

1.50 1.00

6,00,000 4,00,000

(*v*) Debt Collection Period : 1½ months

$$\frac{\text{Debtors}}{\text{Sales}} \times 12 = 1.5 \qquad \frac{X}{20,00,000} \times 12 = 1.5$$

$$X = 20,00,000 \times \frac{1.5}{12}$$

$$\text{Debtors} = 2,50,000$$

(*vi*) Turnover to Fixed Assets : 1.5

$$\frac{\text{Cost of Goods Sold}}{\text{Fixed Assets (X)}} = 1.5$$

$$X = \frac{15,00,000}{1.5}$$

$$\text{Fixed Assets} = 10,00,000$$

(*vii*) Fixed Assets to : Networth = 5/6

↓ ↓

5 : 6

10,00,000 : 12.00,000

$$\left[\frac{10,00,000}{5} \times 6 = 12,00,000\right]$$

Notes

(*viii*) Ratio of Reserves to Share Capital = 1/3

Reserves	+	Share Capital	=	Net Worth
1	+	3	=	4
3,00,000	+	9,00,000	=	12,00,000
		↓		↓

$$\left[\frac{12,00,000}{4} \times 3 = 9,00,000\right]$$

Balance Sheet

Liabilities	₹	Assets	₹
Share Capital	9,00,000	Fixed Assets	10,00,000
Reserves	3,00,000	Current Assets	6,00,000
Current Liabilities	4,00,000		
	16,00,000		16,00,000

Illustration 7. *From the following information you are required to prepare a balance sheet :*

Current Ratio	–	*1.75*
Liquid Ratio	–	*1.25*
Stock Turnover Ratio (Cost of Sales /Closing Stock)	–	*9*
Gross Profit Ratio	–	*25%*
Debt Collection Period	–	*1 ½ months*
Reserves and Surplus to Capital	–	*0.2*
Turnover of Fixed Assets	–	*1.2*
Capital Gearing Ratio	–	*0.6*
Fixed Assets to Net worth	–	*1.25*
Sales for the year	–	*₹ 12,00,000*

Solution.

(*i*)

Cost of Goods Sold	+	GP	=	Sales
↓		↓		↓
75%	–	25%	=	100%
9,00,000	+	3,00,000	=	12,00,000

(*ii*) Stock Turnover Ratio = 9

$$\frac{\text{Cost of Goods Sold}}{\text{Average Stock (X)}} = 9 \qquad \frac{9,00,000}{X} = 9$$

$$X = \frac{9,00,000}{9}$$

$$\text{Stock} = 1,00,000$$

(*iii*) Current Ratio 1.75 3,50,000

Quick Ratio	1.25	2.50,000
Stock	0.50	1.00,000

(*iv*) Debt Collection Period = 1 ½ months

$$\frac{\text{Debtors}}{\text{Sales}} \times 12 = 1.5$$

Debtors = 1,50,000

$$X = 12,00,000 \times \frac{1.5}{12}$$

Debtors = 1,50,000

(*v*) Turnover of Fixed Assets 1.2

$$\frac{\text{Turnover}}{\text{(X) Fixed Assets}} = 1.2 = \frac{9,00,000}{X} = 1.2$$

$$X = \frac{9,00,000}{1.2}$$

Fixed Assets = 7.50,000

(*vi*) Fixed Assets to : Networth = 1.25 : 1

↓ ↓

1.25 : 1.00

7,50,000 : 6,00,000

(*vii*) Reserves and Surplus to Capital : 0.2 : 1

Reserves	+	Share Capital	=	Net Worth
0.2	+	1.00	=	1.2
↓		↓		↓
1,00,000	+	5,00,000	=	6,00,000

$$\left[\frac{6,00,000}{1.2} \times 1 = 5,00,000\right]$$

(*viii*) Capital Gearing Ratio

$$\frac{(X)\ \text{Fixed Interest Bering}}{\text{Equity Share Capital}} = 0.6$$

X = 5,00,000 × 0.6

Long-term Debt = ₹ 3,00,000

Balance Sheet

Liabilities	₹	Assets	₹
Equity Share Capital	5,00,000	Fixed Assets	7,50.000
Long-term Debt	3,00,000	Current Assets	3,50,000
Reserves	1,00,000		

Notes

Current Liabilities	2,00,000		
	11,00,000		11,00,000

Notes

NOTE : Current Ratio

Current Assets	:	Current Liabilities
1.75		1.00
3,50,000		2,00,000

Illustration 8. *Using the information and the form given below compute the balance sheet items for a firm having a sale of ₹ 36 lakhs.*

Sales/Total Assets	*3*	*Sales/Debtors*	*15*
Sales/Fixed Assets	*5*	*Current Ratio*	*2*
Sales/Current Assets	*7.5*	*Total Assets/Net worth*	*2.5*
Sales/Inventories	*20*	*Debt Equity*	*1*

Balance Sheet

Liabilities	₹	Assets	₹
Networth	***	*Fixed Assets*	***
Long-term Debt	***	*Inventories*	***
Current Liabilities	***	*Debtors*	***
		Liquid Assets	***
		Current Assets	***

Solution.

1. Sales : Total assets = 3
   ↓ ↓
   3 : 1
   36,00,000 : 12,00,000
2. Sales : Fixed assets = 5
   5 : 1
   36,00,000 : 7,20,000
3. Sales : Current assets = 7.5
   7.5 : 1.00
   36,00,000 : 4,80,000
4. Sales : Inventories
   20 : 1
   36,00,000 : 1,80,000
5. Sales : Debtors
   15 : 1.00

36,00,000	:	2,40,000
6. Current Ratio	:	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$
2	:	1.00
4,80,000	:	2,40,000
7. Total Assets	:	Net worth = 2.5
↓		↓
2.5	:	1.00
12,00,000	:	4,80,000
8. Debt	:	Equity
1.0	:	1.0
4,80,000	:	4,80,000

Notes

Balance Sheet

Liabilities	₹	Assets	₹
Net worth	4,80,000	Fixed Assets	7,20,000
Long-term Debt	4,80,000	Inventories	1,80,000
Current Liabilities	2,40,000	Debtors	2,40,000
		Liquid Assets	60,000
	12,00,000		12,00,000

Current Assets		4,80,000
Debtors	2,40,000	
Stock	1,80,000	
		4,20,000
Liquid Assets		60,000

Illustration 9. From the following information compute the Balance sheet

Total Assets/Net worth	=	3.5
Sales to fixed Assets	=	6
Sales to current Assets	=	8
Sales to inventory	=	15
Sales to Debtors	=	18
Current Ratio	=	2.5
Annual sales	=	₹ 25,00,000

Solution.

(*i*) Sales to Fixed Assets = 6 : 1

↓ ↓

25,00,00 4,16,667

(*ii*) Sales to Current Assets = 8

$$\frac{\text{Sales}}{(\text{X})\text{ Current Assets}} = 8$$

$$\text{X} = \frac{25,00,000}{8}$$

Notes

Current Assets = 3,12,500

(*iii*) Debtors = $\frac{\text{Sales}}{(\text{X})\text{ Debtors}} = 18$

$$\text{X} = \frac{25,00,000}{18} = 1,38,889$$

(*iv*) Sales : Inventory = 15 : 1

15 : 1

↓ ↓

25,00,000 : 1,66,667

(*v*) Current Ratio

Current Assets : Current Liabilities

2.5 : 1.0

↓ ↓

3,12,500 : 1,25,000

(*vi*) Total Assets : Net worth = 3.5

3.5 : 1.00

↓ ↓

7,29,167 : 2,08,333

$$\left[\frac{7,29,167}{3.5} \times 1.00 = 2,08,333\right]$$

Total Assets	=	Fixed Assets	4,16,667
		Current Assets	3,12,500
			7,29,167

Long Term Debt :

Total Assets = [Net worth + Current Liabilities]

7,29,167 = [1,78,667 + 1,25,000]

Long-term Debt = ₹ 4,25,500

Balance Sheet

Liabilities	₹	Assets	₹
Net worth	1,78,667	Fixed Assets	4,16,667
Long-term Debt	4,25,500	Current Assets	3,12,500
Current Liabilities	1,25,000		
	7,29,000		7,29,167

Current Assets :

Inventory	1,66,667
Debtors	1,38,889
Liquid Assets	6,944
Current Assets	3,12,500

Illustration 10. Following are the ratios to the trading activities of Indian Traders Ltd.

Debtor's Velocity	*3 months*
Stock Velocity	*8 months*
Creditors Velocity	*2 months*
Gross Profit Ratio	*25%*

Gross Profit for the year ended 31.12.2001 amounts to ₹ 4,00,000. Closing stock of the year is ₹ 10,000 above the opening stock. Bills receivable are worth ₹ 25,000 and bills payable ₹ 10,000.

Find out (a) Sales (b) Sundry Debtors (c) Closing Stock and (d) Sundry Creditors.

Solution.

1.

Cost of Goods Sold	+	GP	=	Sales
75%	+	25%	=	100%
↓		↓		↓
12,00,000	+	4,00,000	=	16,00,000

2. Debtor's Velocity : 3 months

$$\frac{\text{Debtors}}{\text{Sales}} \times 12 = 3, \textit{ i.e.}, \frac{X}{16,00,000} \times 12 = 3$$

$$= 4,00,000$$

Less : Bills receivable = 25,000

Sundry Debtors = 3,75,000

3. Stock Velocity : 8 months

$$\frac{\text{Cost of Goods Sold}}{\text{Average Stock (X)}} \times 12 = 8 = \frac{12,00,000}{X} \times 12 = 8$$

$$X = 12,00,000 \square \frac{8}{12}$$

Average Stock = 8,00,000

Total Stock Value 8,00,000 × 2 = 16,00,000

Excess Stock = 10.000

15,90,000

Opening Stock = 7,95,000

7,95,000

Closing Stock = 7,95,000

Notes

$$\text{Excess Value} = 10{,}000 \qquad 8{,}05{,}000$$
$$16{,}00{,}000$$

4. Sundry Creditors

Opening Stock	+	Purchase – Closing Stock	=	Cost of Goods Sold
7,95,000	+	x – 8,05,000	=	12,00,000
x = 12,00,000	+	8,05,000 – 7,95,000	=	12,10,000

5.
$$\text{Creditor's Velocity} = 2 \text{ months}$$
$$\frac{\text{Creditors + Bills Payable}}{\text{Purchase}} \times 12 = 2, \text{ i.e., } \frac{X}{12{,}00{,}000} \times 12 = 2$$
$$\text{Account Payable} = 2{,}01{,}667$$
$$\textit{Less}: \text{Bills Payable} = 10{,}000$$
$$\text{Creditors} = 1{,}91{,}667$$

Illustration 11. *From the following information prepare a Balance Sheet with as many details as possible.*

Gross Profit	*₹ 80,000*	*Current Assets*	*₹ 1,50,000*
Gross Profit to Cost of Goods Sold Ratio	*1/3*	*Account Payable Velocity*	*90 days*
Stock Velocity	*6 times*	*Bills Receivable*	*₹ 20,000*
Opening Stock	*₹ 36,000*	*Bills Payable*	*₹ 5,000*
Account Receivable Velocity (Year 360 days)	*72 days*	*Fixed Assets Turnover Ratio*	*8 times*

Note : Turnover refer to Cost of Sales.

Solution.

1.

Cost of Goods Sold	+	GP	=	Sales
↓		↓		↓
3	+	1	=	4
2,40,000	+	80,000	=	3,20,000

2.
$$\text{Stock Velocity} = 6 \text{ times}$$
$$\frac{\text{Cost of Goods Sold}}{\text{Average Stock (X)}} = \frac{2{,}40{,}000}{X} = 6$$
$$\therefore \quad \text{Average Stock} = 40{,}000$$

3.
$$\text{Average Stock} = ₹\ 40{,}000$$
$$\text{Full Stock Value} = 40{,}000 \times 2 = 80{,}000$$
$$\textit{Less}: \text{Opening Stock} = 36{,}000$$
$$\text{Closing Stock} = 44{,}000$$

4. Debtors Velocity

$$\frac{\text{Debtors} + \text{Bill Receivable}}{\text{Sales}} \times 360 = 72$$

$$X = 3{,}20{,}000 \times \frac{72}{360} = 64{,}000$$

$\therefore$ Drs + Bills Receivable = 64,000

Less : Bills Receivable = 20,000

Debtors = 44,000

5. Creditor's Velocity or Accounts Payable Velocity

$$\frac{\text{Creditors} + \text{Bills Payable}}{\text{Purchase}} \times 360 = 90, \textit{ i.e., } \frac{X}{12{,}48{,}000} \times 360 = 90$$

$$X = 2{,}48{,}000 \times \frac{90}{360}$$

Bills Payable + Creditors = 62,000

Less : Bills payable = 5,000

Creditors = 57,000

Find out the Purchases

Opening Stock	+	Purchase	–	Closing Stock	=	Cost of Goods Sold
↓		↓		↓		↓
36,000	+	x	–	44,000	=	2,40,000
x = 2,40,000	+	44,000 – 36,000				
Purchase ₹	=	2,48,000				

6. Fixed Assets Turnover Ratio

$$\frac{\text{Turnover}}{\text{Fixed Assets}\,(X)} = 8, \textit{ i.e., } X = \frac{2{,}40{,}000}{8}$$

Fixed Assets = 30,000

Balance Sheet

Liabilities	₹	Assets	₹
Capital (B/F)	1,18,000	Fixed Assets	30,000
Creditors	57,000	Closing Stock	44,000
Bills Payable	5,000	Debtors	44,000
		Bills Receivable	20,000
		Other Current Assets	42,000
	1,80,000		1,80,000

Total Current Assets given :		1,50,000
Stock	44,000	
Debtors	44,000	
B.R.	20,000	1,08,000
Other Current Assets		42,000

Notes

Illustration 12. From the following information presented by a firm for the year ended 31st December, find out :

(i) Net worth	*(ii) Current Liabilities*
(iii) Total Debt to Net worth	*(iv) Long-term Debt*
(v) Current Assets	*(vi) Stock*
(vii) Debtors and	*(viii) Fixed Assets*

Sales to Net worth	:	*5 times*
Current Liabilities to Net worth	:	*50%*
Total Debts to Net worth	:	*60%*
Current Ratio	:	*2*
Sales to Stock	:	*10 times*
Debtor's Velocity	:	*9 times*
Annual Sales	:	*₹ 15,00,000*
Cash Sales	:	*40% of Sales*

Solution.

(*i*) Sales to Net worth : 5 times

Sales : Net worth

5 : 1

15,00,000 : 3,00.000

$$\left[\frac{15,00,000}{5}\times 1 = 3,00,000\right]$$

(*ii*) Current Liabilities to Net worth

Current Liabilities = 50% of ₹ 3,00,000

= 1,50,000

(*iii*) Total Debt to Net worth = 60%

Total Debt is 60% of 3,00,000 = 1,80,000 (or)

Total Debt : Net worth

60% : 100%

↓ ↓

1,80,000 : 3,00,000

(*iv*) Long-term Debt

Long term Debt = Total Debt – Current Liabilities

= 1,80,000 – 1,50,000 = 30,000

(*v*) Current Assets

Current Ratio

Current Assets : Current Liabilities

2.0 : 1.00

3.00,000 : 1,50,000

Notes

(*vi*) Stock

Sales to Stock = 10 times

Sales	:	Stock
10.0	:	1.00
15,00,000	:	1,50,000

(*vii*) Debtor's Velocity : 9 times

$$\text{Credit Sales} = 15,00,000 \times \frac{60}{100}$$

$$= 9,00,000$$

$$\text{Debtor's Turnover Ratio} = \frac{\text{Debtors}\,(X)}{\text{Sales}} = 9,$$

$$\text{i.e., } \frac{X}{9,00,000} = 9$$

$$X = \frac{9,00,000}{9}$$

$$\text{Debtors} = 1,00,000$$

(*viii*) Fixed Assets

Fixed Assets to Net worth Ratio = 60%

$$\left[\frac{3,00,000}{100} \times 60 = 1,80,000\right]$$

i.e., Fixed Assets	:	Net worth
↓		↓
60%	:	100%
1,80,000	:	3,00,000

Illustration 13. *With the help of the following Ratios regarding Narmatha Tex, draw the Trading, Profit and Loss A/c and Balance Sheet of the company for the year 2004.*

(*i*)	*Current Ratio*	:	*2.5*
(*ii*)	*Liquidity Ratio*	:	*1.5*
(*iii*)	*Net working capital*	:	*₹ 3,00,000*
(*iv*)	*Stock Turnover Ratio*	:	*6 times (Cost of Sales/ Closing Stock)*
(*v*)	*Gross Profit Ratio*	:	*20%*
(*vi*)	*Fixed Assets Turnover Ratio (on Cost of Sales)*	:	*2 times*
(*vii*)	*Debt Collection Period*	:	*2 months*
(*viii*)	*Fixed Assets to Shareholder's Net worth*	:	*0.80*
(*ix*)	*Reserves and Surplus to Capital*	:	*0.5*

Notes

Solution. :

1.

Current Assets	–	Current Liabilities	=	Working Capital
↓		↓		↓
2.5	–	1.00		1.5
↓		↓		↓
5,00,000	↓	2,00,000	=	3,00,000

2.

Stock Velocity	2.5	→ 5,00,000
Liquidity Ratio	1.5	→ 3,00,000
Stock	1.0	→ 2,00,000

3. Stock Turnover Ratio : 6 times

$$\frac{(X)\text{ Cost of Goods Sold}}{\text{Closing Stock}} = 6. \textit{ i.e., } \frac{X}{2,00,000} = 6$$

$$\text{Cost of Goods Sold} = 12,00,000$$

4.

Cost of Goods Sold	+	GP	=	Sales
80%	+	20%	=	100%
12,00,000	+	3,00,000	=	15,00,000

$$\left[\frac{12,00,000}{80} \times 20\right] = 3,00,000$$

5.

$$\text{Debt Collection Period} = 2 \text{ months}$$

$$\frac{X \text{ Drs} + \text{BR}}{\text{Sales}} \times 12 = 2, \textit{ i.e., } \frac{X}{15,00,000} \times 12 = 2$$

$$X = 15,00,000 \times \frac{2}{12}$$

$$\text{Debtors} + \text{BR} = 2,50,000$$

6. Fixed Assets Turnover Ratio

$$\frac{\text{Turnover}}{\text{Fixed Assets}} = 2, \textit{ i.e., } \frac{12,00,000}{X} = 2$$

$$X = \frac{12,00,000}{2} = 6,00,000$$

7. Fixed Assets to Shareholder's Net worth = .80

$$\frac{\text{Fixed Assets }(6,00,000)}{\text{Shareholder's Net worth (X)}} = .80$$

$$X = \frac{6,00,000}{.80}$$

$$\text{Shareholder's Net worth} = 7,50,000$$

8. Reserves and Surplus to capital : 0.5

Reserves	+	Share Capital	=	Net Worth
.50	+	1.00	=	1.50
↓		↓		↓
2,50,000	+	5,00,000	=	7,50,000

Balance Sheet

Liabilities	₹	Assets	₹
Share Capital	5,00,000	Fixed Assets	6,00,000
Reserves and Surplus	2,50,000	Current Assets	5,00,000
Current Liabilities	2,00,000		
Long-term Loan	1,50,000		
	11,00,000		11,00,000

Total Current Assets given :		5,00,000
Stock	2,00,000	
Debtors	2,50,000	4,50,000
Cash		50,000

Illustration 14. From the following figures and ratios draw out trading, profit and loss account and balance sheet.

Share capital = 1,80,000

Working capital = 63,000

Bank overdraft = 10,000

There is no fictitious asset. In current assets there is no asset other than Stock debtors and cash. Closing stock is 20% higher than the opening stock.

Current Ratio	:	*2.5*
Proprietary Ratio	:	*0.7*
Stock Velocity	:	*4*
Net Profit Ratio	:	*10% (to average Capital employed)*
Quick Ratio	:	*1.5*
Gross Profit Ratio	:	*20% to Sales*
Debtor's Velocity	:	*365 days*

Solution. Gross Profit ₹ 38,500, NP 23,950 B/s total 2,22,000.

Illustration 15. *With the following Ratios and further information given below, prepare Trading, Profit and Loss A/c and a Balance Sheet of Shri Surjit & Co.*

(i)	*Gross Profit Ratio*	:	*25%*
(ii)	*Net Profit/Sales*	:	*20%*
(iii)	*Stock Turnover Ratio*	:	*10*
(iv)	*Net Profit Capital*	:	*1/5*
(v)	*Capital to Total Liabilities*	:	*1/2*

(vi)	*Fixed Assets/Capital*	*: 5/4*
(vii)	*Fixed Assets/Total Current Assets*	*: 5/7*
(viii)	*Fixed Assets*	*: ₹ 10,00,000*
(ix)	*Closing Stock*	*: ₹ 1,00,000*

Notes

Solution.

(*i*) Capital

Fixed Assets	:	Capital
5	:	4
10,00,000	:	8,00,000

$$\left[\frac{5}{10,00,000}\times 4\right] = 8,00,000$$

(*ii*) Net Profit Ratio

Net Profit	:	Capital
1.00	:	5.00
↓		↓
1,60,000		8,00,000

(*iii*) Net Profit/Sales : 20%

$$\frac{\text{Net Profit }(1,60,000)}{\text{Sales}(X)}\times 100 = 20\%$$

$$X = 1,60,000\times\frac{100}{20}$$

$$\text{Sales} = ₹\ 8,00,000$$

(*iv*)

Cost of Goods Sold	+	GP	=	Sales
75%	+	25%		100%
6,00,000	+	2,00,000		8,00,000

(*v*) Stock Turnover Ration

$$\frac{\text{Cost of goods sold }(6,00,000)}{\text{Average Stock }(X)} = 10$$

$$X = \frac{6,00,000}{10}$$

$$\text{Average stock} = 60,000$$

Actual/Full stock value 60,000 × 2	1,20,000
Less : Closing Stock	1,00,000
Opening Stock	20,000

(*vi*) Total Liabilities : Capital to total liabilities $\frac{1}{2}$

$$\frac{\text{Capital}}{(X)\text{ Total Liabilities}} = \frac{1}{2}$$

Notes

$$\frac{8,00,000}{\text{Total Liabilities}}$$

$$X = 8,00,000 \times 2 = 16,00,000$$

(*vii*) Total Current Assets

Fixed Assets to Total Current Assets : 5/7

$$\text{Fixed Assets} = ₹\ 10,00,000$$

$$\frac{\text{Fixed Assets}}{(X)\ \text{Total Current Assets}} = 5/7$$

$$X = 10,00,000 \times \frac{7}{5}$$

$$= 14,00,000$$

Less : Closing Stock = 1,00,000

Current Assets = 13,00,000

Trading and Profit and Loss Account for the year ended

	₹		₹
To Opening Stock	20,000	By Sales	8,00,000
To Purchases	6,80,000	By Closing Stock	1,00,000
To Gross Profit	2,00,000		
	9,00,000		9,00,000
To Expenses	40,000	By Gross Profit	2,00,000
To Net Profit	1,60,000		
	2,00,000		2,00,000

Balance Sheet

Liabilities	₹	Assets	₹
Share Capital (8,00,000 – 1,60,000)	6,40,000	Fixed Assets	10,00,000
Net Profit	1,60,000	Stock	1,00,000
Current Liabilities	16,00,000	Other Current Assets	13,00,000
	24,00,000		24,00,000

Illustration 16. *You are given the following information pertaining to the Financial Statements of Reliance Ltd as on 31.12.2004. On the basis of the information supplied, you are required to prepare Trading, Profit and Loss Account for the year ended and a Balance Sheet as on the date.*

Net Current Assets	:	*2,00,000*
Issued Share Capital	:	*6,00,000*
Current Ratio	:	*1.8*
Quick Ratio [Ratio of Debtors and Bank Balance to Current Liabilities]	:	*1.35*

Notes

Fixed Assets to Shareholder's Equity	:	*80%*
Ratio of Gross Profit on Turnover	:	*25%*
Net Profit to Issued Share Capital	:	*20%*
Stock Turnover Ratio	:	*5 times*
Average of Outstanding for the year	:	*36 ½ days*

On 31.12.2004, the Current Assets consisted only of Stock Debtors and Bank Balance. Liabilities consisted of Share Capital, Current Liabilities and Assets consisted of Fixed Assets and Current Assets.

Solution.

1.

Current Assets	–	Current Liabilities	=	Working Capital
1.8		1.00		.8
4,50,000	–	2,50,000	=	2,00,000

2. Quick Ratio

Quick Assets	:	Current Liabilities
1.35		1.00
3,37,500		2,50,000

3. Stock

$$\text{Current Assets} - \text{Quick Assets} = \text{Stock}$$
$$4{,}50{,}000 - 3{,}37{,}500 = 1{,}12{,}500$$

4. Stock Turnover

$$\frac{\text{Cost of Goods Sold }(X)}{\text{Closing Stock }(1{,}12{,}500)} = 5$$
$$X = 1{,}12{,}500 \times 5 = 5{,}62{,}500$$

5. Ratio of Gross Profit on Turnover 25%

Cost of Goods Sold	+	GP	=	Sales
75%	+	25%		100%
5,62,500	+	1,87,500		7,50,000

6. Debtor's Turnover Ratio (Here, there are no Bills Receivable)

$$\frac{\text{Drs}}{\text{Sales}} \times 365 = \text{i.e., } \frac{X}{7{,}50{,}000} \times 365 = 36.5$$
$$X = 7{,}50{,}000 \times \frac{36.5}{365}$$
$$\text{Debtors} = ₹\,75{,}000$$

7. Quick Assets (Debtors + Bank) = 3,37,500
Less : Debtors = 75,000
Cash in hand = 2,62,500

8. Net Profit to Issued Share Capital : 20%

20% : 100

↓ ↓

1,20,000 : 6,00,000

$$\left[\frac{6,00,000}{100} \times 20\right] = 1,20,000$$

9. Fixed Assets

Fixed Assets to Shareholder's Equity, change into

Shareholder's equity	–	Fixed Assets	=	Net Current Assets
↓		↓		↓
100%	–	80%	=	20
↓		↓		↓
10,00,000	–	8,00,000	=	2,00,000

$$\left[\frac{2,00,000}{20} \times 80\right] = 8,00,000$$

Trading and Profit and Loss Account for the year ended

	₹		₹
To Cost of Goods Sold	5,62,500	By Sales	7,50,000
To Gross Profit	1,87,500		
	7,50,000		7,50,000
To Expenses	67,500	By Gross Profit	1,87,500
To Net Profit	1,20,000		
	1,87,500		1,87,5000

Balance Sheet

Liabilities	₹	Assets	₹
Share Capital	6,00,000	Fixed Assets	8,00,000
Reserves and Surplus (B/F)	2,80.000	Current Assets :	
		Stock	1,12,500
		Debtors	75,000
		Bank	2,62,500
Profit for the year	1,20,000		
Current Liabilities	2,50,000		
	12,50,000		12,50,000

Illustration 17. The following are the Ratios and other details of Rubix Ltd. :

Debtor's velocity	:	*3 months*
Creditor's velocity	:	*2 months*
Stock turnover	:	*8 times*

Capital - turnover Ratio : *2.5 times*

Fixed Assets - Turnover Ratio : *8 times*

Gross profit Turnover Ratio : *25%*

Notes

Gross Profit in a year amounts to ₹ 80,000. There is no Long-term Loan or Overdraft. Reserves and Surplus amount to ₹ 28,000. Liquid Assets are ₹ 97,333. Closing Stock of the year is ₹ 2,000 more than the Opening Stock. Bills Receivable amount to ₹ 5,000 and Bills Payable to ₹ 2,000.

Find out :

(i) Sales	*(ii) Sundry Debtors*
(iii) Sundry Creditors	*(iv) Closing Stock*
(v) Fixed Assets	*(vi) Proprietor's Fund*

Construct the Balance Sheet with as many details as possible.

Solution.

(*i*) Sales

Cost of Goods Sold	+ GP	– Sales
75%	25%	100%
2,40,000	80,000	3,20,000

(*ii*) Debtor's Turnover Ratio (Here, there are no Bills Receivable)

$$\text{Debtor's Velocity} = \frac{\text{Debtors} + \text{Bill Receivable}\,(X)}{\text{Sales}\,(3,20,000)} \times 12$$

$$X = 3,20,000 \times \frac{3}{12} = 80,000$$

$$\text{Debtors} + \text{Bills Receivable} = 80,000$$

$$\text{Less : Bills Receivable} = 5,000$$

$$\text{Debtors} = 75,000$$

(*iii*) Sundry Creditors

$$\frac{\text{Creditors} + \text{Bills Payable}}{\text{Purchase (Credit)}} \times 12 = 2$$

$$X = 2,42,000 \times \frac{2}{12} = 40,333$$

$$\textit{Less :}\ \text{Bills Payable} = 2,000$$

$$\text{Creditors} = 38,333$$

Find out the purchase

Opening Stock	+	Purchase – Closing Stock	=	Cost of Goods Sold
29,000	+	X – 31,000	=	2,40,000
X = 2,40,000	+	31,000 – 29,000		
X = 2,42,000	*i.e.,*	Purchase = ₹ 2,42,000		

Notes

(*iv*) Closing Stock

$$\frac{\text{Cost of Goods Sold}}{\text{Average Stock (X)}} = 8$$

$$X = \frac{2,40,000}{8}$$

Average Stock = 30,000

Total Stock Value 30,000 × 2 = 60,000

Less : Excess = 2,000

58,000

Opening Stock = 29,000

Closing Stock 29,000 + 2,000 = 31,000

(*v*) Fixed Assets

$$X = \frac{3,20,000}{8} = 40,000$$

Fixed Assets Turnover Ratio = 8

(*vi*) Proprietor's Fund

Proprietor's Fund = Fixed Assets + Stock + Liquid Assets – Current Liability

= 40,000 + 31,000 + 97,333 – 40,333 = ₹ 1,28,000

Cash and Bank Balance

Quick Assets		97,333
Less : Bills Receivable	5,000	
Debtors	75,000	80,000
Cash at Bank		17,333

Balance Sheet

Liabilities	₹	Assets	₹
Share Capital	1,00,000	Fixed Assets	40,000
Reserves and Surplus	28,000	Stock	31,000
Bills Payable	2,000	Debtors	75,000
Sundry Creditors	38,333	Bills Receivable	5,000
		Cash and Bank	17,333
	1,68,333		1,68,333

Illustration 18. *From the following information of a Textile Company complete the Proforma balance Sheet if Sales are worth ₹ 28,00,000.*

Sales to Net worth	=	*2.3 times*
Current Debt to Net worth	=	*42%*
Total Debt to Net worth	=	*75%*
Current Ratio	=	*2.9 times*
Net Sales to Inventory	=	*4.7 times*

Average Collection Period	=	*64 days*
Fixed Assets to Net worth	=	*53.2%*

Preforms Balance Sheet

Notes

Net worth	?	*Fixed Assets*	?
Long-term Debt	?	*Cash*	?
Current Debt	?	*Stock*	?
		Sundry Debtors	?

Solution.

1. Sales to Net worth : 2.3 times

$$\frac{\text{Sales}\left(23,00,000\right)}{\text{Net worth}\left(X\right)} = 2.3 \text{ times}$$

$$X = \frac{23,00,000}{2.3} = 10,00,000$$

Net worth = ₹ 10,00,000

2. Current Debt

Current Debt	:	Net worth
↓		↓
42%	:	100%
↓		↓
4,20,000		10,00,000

$$\frac{10,00,000}{100} \times 42 = 4,20,000$$

3. Total Debt

Total Debt to Net worth	=	75%
Total Debt	:	Net worth
75%	:	100
7,50,000	:	10,00,000

[*i.e.*, Total debt is 75% of net worth $10,00,000 \times \frac{75}{100} = 7,50,000$]

4. Long-term Debt

Long-term Debt = Total Debt – Current Debt
= 7,50,000 – 4,20,000
= 3,30,000

5. Current Assets

Current Ratio	:	2.9
Current Assets	:	Current Liabilities
2.9		1.0

12,18,000 4,20,000

$$\frac{4,28,000}{10} \times 2.9 = 12,18,000$$

6. Inventory

Net Sales to Inventory

$$\frac{\text{Sales}(23,00,000)}{\text{Inventory}(X)} = 4.6 \text{ times}$$

$$X = \frac{23,00,000}{4.6}$$

$$\text{Inventory} = 5,00,000$$

7. Debtor

Average Collection Period

Here, there is no bill receivable. Hence, the formula

$$\frac{\text{Debtors}(X)}{\text{Sales}(23,00,000)} \times 360 = 90$$

$$X = 23,00,000 \times \frac{90}{360}$$

$$\text{Debtors} = 5,75,000$$

8. Fixed Assets

Fixed Assets to Net worth

$$\frac{\text{Fixed Assets}}{\text{Net worth}} = 53.2\%$$

Fixed Assets	Net worth
↓	↓
53.2%	100%
5,32,000	10,00,000

$$\frac{10,00,000}{100} \times 53.2$$

9. Find out the Cash

Total Current Assets		12,18,000
Less Stock	5,00,000	
Debtors	5,75,000	10,75,000
Cash		1,43,000

Balance Sheet

Liabilities	₹	*Assets*	₹
Net worth	10,00,000	Fixed Assets	5,32,000
Long-term Debt	3,30,000	Debtors	5,75,000
Current Debt	4,20,000	Stock	5,00,000
		Cash	1,43,000
	17,50,000		17,50,000

Notes

Illustration 19. Srinivasan Cotton Company's Stock Turnover is 5 times stock at the end is ₹ 20,000 which is more than at the beginning. Sales (all Credit) are ₹ 8,00,000. Rate of Gross Profit on Cost is 1/4. Current Liabilities ₹ 1,20,000. Quick Ratio is 0.75. Calculate Current Assets.

Notes

Solution.

$$\text{Stock Turnover Ratio} = \frac{\text{Cost of Goods Sold}\left(6,00,000\right)}{\text{Average Stock}\left(X\right)} = 5$$

$$X = \frac{6,00,000}{5} = 1,20,000$$

$$\text{Average Stock} = 1,20,000$$

NOTE :

Cost of Goods Sold	=	Sales	–	Gross Profit
	=	8,00,000	–	2,00,000 = 6,00,000
Total Stock Value	:	1,20,000 × 2		2,40,000
Less : Excess Value				20,000
				2,20,000

Opening Stock = ₹ 1,10,000

Closing Stock = ₹ 20,000 + 1,10,000 = 1,30,000

Quick Ratio :

Quick Ratio	:	Current Liabilities
↓		↓
.75		1.00
↓		↓
90,000		1,20,000

Current Assets

Quick Assets = ₹ 90,000

Closing Stock = ₹ 1,30,000

Current Assets = ₹ 2,20,000

Illustration 20. *Calculate Stock Turnover Ratio from the following details :*

(i) Opening Stock ₹ 29,000

(ii) Closing Stock ₹ 31,000

(iii) Sales ₹ 3,20,000

(iv) Gross Profit – Ratio 25% on Sales

Solution.

$$\text{Stock Turnover Ratio} = \frac{\text{Cost of Goods Sold}}{\text{Average Stock}}$$

$$= \frac{2,40,000}{30,000} = 8 \text{ times}$$

$$\text{Average Stock} = \frac{29,000 + 31,000}{2} = 30,000$$

Cost of Goods Sold	+	GP	–	Sales
75%	+	25%		100%
2,40,000		80,000		3,20,000

Notes

4.6. Financial Analysis

Financial Analysis is the systematic numerical calculation of the relationship of one financial fact with the other to measure the profitability, operational efficiency, solvency and the growth potential of the business. The analysis serves the interest of shareholders. debenture-holders, potential investors, account payable, bankers, journalists, legislators, politicians, researchers, stock exchanges, taxation authorities politicians, researchers, stock exchanges, taxation authorities and economists. The analysis of financial statements makes it simple, intelligible and meaningful for all the concerned parties. Financial statements are split into simple statements by the process of rearranging, regrouping and the calculations of various ratios. The analysis simplifies, summarizes and systematises the monotonous figures.

Financial analysis in this way is the purposeful and systematic presentation of financial statements. Various items of income and position statements are compared and their inter-relationship is established . Financial analysis, as such presents meaningful, expression of the relationship between different items, such as relationship between gross profit and net sales.

Suppose the Gross profit of the company is ₹ 25,000 and Net sales are worth ₹ 1,00,000. At the same time the Gross profit of the second company is ₹ 30,000, and the net sales amounts to ₹ 2,00,000. According to these figures, the company which has earned ₹ 30,000, as profit may be said to be superior as regards its performance. If we analysis the figures, we come to know that the Gross profit margin of the first company amount to 25% *i.e.*, $\frac{25,000}{1,00,000} \times 100$ and the second company amounts to 15% *i.e.*, $\frac{30,000}{2,00,000} \times 100$. As such analysis show that the operational efficiency of the first company is better than the second company.

The use of financial analysis is made to measure the profitability, efficiency and financial soundness of the business, to make comparative studies and effective future plans.

Parties interested in the Financial Analysis

Every person concerned with the affairs of the business has an interest in the financial statements of the business. The information available from the analysis, serves the interest of different sections. The following parties have an interest in the analysis of financial statements:

1. **Management.** The management needs information regarding the profitability, operational efficiency and financial soundness of the business,

so that weaknesses of the business may be identified and effective business plans may be formulated.

2. **Shareholders.** The shareholders, the virtual owners of business corporate units have an interest in the welfare and progress of the business. They want to know about the profitability and future prospects of the enterprise. The requisite information is available from the analysis of financial statements.
3. **Workers.** Employees of the business are interested in the profit of the business. In case of sufficient profits, labour unions have moral justification to demand for higher wages. Workers in the business are paid bonus on the basis of productivity and profitability, so they have an interest in the financial analysis of the business.
4. **Account Payable.** Creditors of the enterprise are interested in the short-term and long-term financial soundness of the business. They want to ensure themselves, whether their funds are safe and secured and the business is capable of making payment of interest regularly and also refund as per agreements.
5. **Government.** Financial statements help government in determining tax liability. The government is also capable of ascertaining the economic development of the country through the financial analysis. The government requires the information for formulating effective economic plans and balanced growth of different sectors and regions of the economy.
6. **Potential investors.** The potential investors of the business have an interest in the operational efficiency and profit earning capacity of the business unit. They would like to know, how far their previous investment has been safe and how much the new investment will be safer and secured.
7. **Economist and researchers.** These parties are interested in the financial activities of the business, so that they amy study the financial health of the economic structure of the business, study the rate of economic growth, compare it with other economics and suggest effective measures to accelerate the pace of growth.
8. **Stock exchange.** It is an institution which deals in securities (*i.e.*, Shares, Debentures, Debentures Inventory, Bonds etc.). In other words, it facilitates purchase and sale of shares and debentures of companies. Stock exchanges are interested in the financial statements, because they have to collect, analyse and report the financial status of the companies.

Type of Financial Analysis/Analysis of Financial Statements

Analysis of financial statements is an art. In this way, It can be presented as under:

- **Horizontal analysis.** According to this method, the relationship between different items of financial statements is established. comparisons are made and results obtained. The basis of this comparison may be:
  - (*i*) Comparison of the financial statements of different years of the same business unit.

(*ii*) Comparison of financial statements of a particular year of different business units.

- **Vertical analysis.** According to this analysis financial statements of the same period of different items of the same financial statements are compared. For example, presenting the value of individual asset as a part of the value of total assets.

Income statement and position statement used as the basis for analysis are known as common size statements (common size Profit and Loss Account and Common size Balance Sheet).

The analysis can be made in the following ways:

(*i*) By preparation of the common size statements of the two similar units.

(*ii*) By preparing common size statements of different years of the same business unit.

Analysis of financial statements is also made on the basis of available information, such analysis is known as External and Internal analysis.

- **External analysis.** This analysis is made on the basis of published statements, reports and informations. These informations of the business are available even to the outsiders.
- **Internal analysis.** This analysis is based upon the information available to the business only. These informations are not published for outside parties. Such pieces of information are used by the management to evaluate managerial and operational efficiency of their performance. It detects the plus points of the business operations and reinforces it. It also discovers weaknesses of the business and tries its best to correct it by applying remedial measures.

Significance/Importance, Purpose and Advantages of Financial Analysis

Financial statements are prepared at a certain point of time according to established conventions. These statements are prepared to suit the requirements of the proprietor. It is therefore, necessary to analyse financial statements to measure the efficiency, profitability, financial soundness and future prospects of the company. Financial analysis serves the following purpose.

1. **Judging the operational efficiency of the business.** It is very significant that the company must know the operational efficiency of its management. We analyse the financial statements, match the amount of manufacturing, selling, distribution and financial expenses of the current year with the corresponding expenses of the previous year and assess the managerial efficiency of the business. We can judge the operational efficiency of the business by calculating profitability ratios.
2. **Measuring short and long-term financial position.** The business must know its financial soundness. It should satisfy itself that its current resources are sufficient to meet its current liabilities. We can calculate current and liquid ratios for comparing current assets and current liabilities to ascertain short-term financial soundness. Long-term financial position can be measured by calculating debt equity, proprietary and fixed assets ratios. The results of the financial analysis may be studied and corrective steps can be taken, if necessary.

3. Indicating the trend of achievements. Financial statements of the previous years can be compared and the trend regarding various expenses, purchases, sales, gross profit and net profit can be ascertained, cost of goods sold, values of assets and liabilities can be compared and the future prospects of the business can be indicated.

4. **Assessing the growth potential of the business.** The trend and dynamic analysis of the business provides us sufficient information indicating the growth potential of the business. If the trend predicts gloomy picture, effective measures can be applied as remedial (corrective) measures. If cost of production is rising without corresponding increase in sales price, efforts should be made to reduce cost of production.

5. **Measuring the profitability.** Financial statements show the gross profit, net profit and other expenses. The relationship of these items can be established with sales. Gross profit, net profit, expenses and operating ratios may be calculated and the profitability of the business ascertained. In case of improving profitability ratios, the causes responsible for this performance should be reinforced.

6. **Intra-firm and inter-firm comparison of the performance.** Analysis of financial statements can be made with the previous year's performance of the same firm and also with the performance of other firms. Intra-firm analysis provides an opportunity to self-appraisal, whereas inter-firm analysis presents the operational efficiency of the firm as compared to other firms. Comparison helps us in detecting our weaknesses and applying corrective measures.

7. **Forecasting, budgeting and deciding future line of action.** Analysis of financial statements predicts the growth potential of the business. Comparison of actual performance with the desired performance shows our shortcomings. The analysis provides sufficient information regarding the profitability, performance and financial soundness of the business on the basis of these informations, we can make effective forecasting, budgeting and planning.

8. **Simplified, systematic and intelligible presentation of facts.** Analysis of financial statement is an effective tool for simplifying, systematising and summarising the monotonous figures. An average person can draw conclusion from these ratios. The facts can be made more attractive by graphs and diagrams, which can be easily understood.

Limitations of Financial Analysis

In spite of all significance of analysis of financial statements as discussed above, it has the following limitations:

1. **Suffering from the limitations of financial statements.** Financial statements suffer from variety of weaknesses. Balance Sheet is prepared on historical record of the value of assets. It is just possible that assets may not have the same value. Financial statements are prepared according to certain conventions at a point of time, whereas the investor is concerned

with the present and future of the company. Certain assets and liabilities are not disclosed. Personal judgment plays an important role in determining the figure of the balance sheet. In other words, we can say that balance sheet cannot be said to have a complete accuracy. Financial statements suffer from these weaknesses, so analysis based upon these statements cannot be said to be always reliable.

2. **Absence of standard universally accepted terminology.** Accounting is not an exact science. It does not have standard, universally accepted terminology. Different meanings are given to a particular term. There are different methods of providing depreciation. Interest may be charged on different rates. In this way, there is sufficient possibility of manipulation and the financial statements have to suffer. As a consequence financial analysis also proves to be defective.
3. **Ignoring price level changes.** The results shown by financial statements may be misleading, if price level changes have not been accounted for. The ratio may improve with the increase in price, whereas the actual efficiency may not improve. Ratios of the two years will not be meaningful for comparison, if the prices of commodities are different. Change in price affects cost of production, sales and values of assets and as a consequence comparability of ratios also suffers.
4. **Ignoring qualitative aspect.** Financial analysis does not measure the qualitative aspects of the business. It does not show the skill, technical know how and the efficiency of its employees and managers. It is the quantitative measurement of the performance. It means that analysis of financial statements measures only the one sided performance of the business. It completely ignores human resources.
5. **Financial statements are affected by window dressing.** The management displays rosy picture of the enterprise through financial statements. Sometimes material informations is concealed. Financial statements sometimes contain false information. In order to show excellent profit, sales may be exaggerated, stock may be over valued and certain purchases may not be shown. In such cases analysis of financial statements will also be incorrect.
6. **Financial statements are affected by the personal ability and bias of analyst.** The figures of financial statements do not speak themselves. These informations are analysed and interpreted by shrewd analysts, who may have their own views, reflected in the analysis. In many situations the accountant has to choose between alternative available *i.e.*, choice between straight line and diminishing balance method of depreciation and choice between LIFO and FIFO method of the valuation of stock. In other words, it is the personal ability of the analyst which manipulates the information of the financial statements in its own favour and satisfy their own whims. As subjectivity is inherent in the personal judgement, so financial statements can never be free from bias. In such cases, financial analysis fails to disclose the true picture.
7. Misleading results in the absence of absence of absolute data. Result

Notes

shown by financial analysis may be misleading in the absence of absolute data. We cannot have the idea of the size of the business. Increase in sales form ₹ 40,000 to 80,000 shows that sales has doubled. In case of other firms increases of sale from ₹ 20,00,000 to 40,00,000 also shows that the sales has doubled but the size of the firm is quite different. Profitability ratio of two firms may be the same, but magnitude of their businesses may be quite different.

Tools of Financial Analysis

The following tools are used to measure the operational efficiency and financial soundness of the enterprise:

Comparative Statements	4 : Ratios Analysis*
Common Size Statements	5 : Funds Flow Statements*
Trend Analysis	6 : Cash Flow Statement**

* Funds Flow Statement and Trend Analysis is out of CBSE syllabus.

** These have been discussed in detail in the next chapters.

4.7. Comparative Statements

Business is a continuing activity with profit motive. An efficient management should not be satisfied with the present performance but should try to discover the possible profit earning possibilities of the business. In order to achieve this objective, the management should compare its current performance with the performance of previous year and identify the plus and minus points of the business. Weaknesses and shortcomings identified by the comparison should be removed as early as possible. In this way, remedial measures may be applied. The plus points may be strengthened. For example, if cost of production is increasing as compared to the previous years, it should be ascertained whether sales is also increasing proportionately. The management should also ensure itself with the causes responsible for the increasing cost of production, whether it is due to the economic policies of the business, unavoidable adverse circumstances of the business or due to the operational inefficiency. In this way we can also compare with the financial statements of other competitive enterprises.

Comparative study of financial statement as such is the comparison of the financial statements of the business with the previous year's financial statements and with the performance of other competitive enterprise, so that weaknesses may be identified and remedial measures applied.

Notes

Format of Comparative Statement of Profit & Loss

For the years ended 31st March .... and 31st March.......

	Particulars (A)	Note No. (B)	Figure at the end of current reporting period (C) (₹)	Figures at the end of Previous reporting period (D) (₹)	Absolute Change (Increase or Decrease) (E) = (C – D) (₹)	Percentage change (Increase) (F) = $\left(E \times \frac{100}{C}\right)$ (%)
I.	**Revenue from Operations**		—	—	—	—
II.	**Other Income**		—	—	—	—
III	**Total Revenue (I + II)**		—	—	—	—
IV.	**Expenses**					
	Cost of Materials Consumed		—	—	—	—
	Purchase of Stock-In-Trade		—	—	—	—
	Changes in Inventories of Finished Goods		—	—	—	—
	Work-in-Progress and Stock-in-Trade		—	—	—	—
	Employees Benefits Expenses		—	—	—	—
	Finance Costs		—	—	—	—
	Depreciation and Amortization Expenses		—	—	—	—
	Other Expenses		—	—	—	—
	Total Expenses		—	—	—	—
V.	**Profit before Tax (III - IV)**		—	—	—	—
VI.	**Tax**		—	—	—	—
VII.	**Profit after Tax (V - VI)**					

Comparison of financial statements can be made, if information of all the statements are uniform. This is why, common size income statements and position statements are prepared. Unless the information are uniform, the purpose of making comparative statement cannot be achieved.

In the words of FAULKE, "*Comparative analysis is the study of trend of the same items and computed from two or more financial statements of the same business enterprise on different dates.*"

Inter-Firm Versus Intra-Firm Comparison

Financial statements can be compared both inter-firm and intra-firm. In case of inter-firm comparison financial statements of two or more firms are compared, whereas in case of intra-firm comparison financial statements of the same enterprise for two or more years are compared. *Intra-firm comparison is also termed as trend analyses. It indicates the trend of the profitability, operational efficiency and financial soundness of the business enterprise. Trend analysis may also be named as horizontal analysis, because each accounting variable is placed and analysed horizontally.*

(A) Comparative Income Statement

It is a statement which shows in percentage term the total of income earned and expenses incurred during the two or more accounting periods. It is useful for the purpose of comparing the income statement over the past few years or quarters etc. It helps the horizontal analysis of each accounting variable for future decision-making purpose.

Notes

Explanation of items

The above format is designed as per the new schedule VI format introduced with effect from 31st March 2012. The items under this format are discussed as below:

Revenue from operations: It indicates the revenue generated from the sale of goods or by providing services to the customers. It includes net sales which is gross sales less returns inward (sales return) and sales tax (if not deducted). If sales return is separately given, it should be deducted from sales to ascertain Net sales. If sales return is not given, sales should be supposed to be Net sales. Also, in the case of service organizations, it will include separate revenue stream of the business like in the case of telecom company (say Airtel) it will be landline revenue, GSM mobile connection revenue, messaging revenue etc.

Profit before tax: If we deduct operating expenses (selling, distribution and administrative expenses) we shall get operating net income. We can get Profit before tax and interest, if we add other income. We can get Profit before tax and interest, if we add other income to operating Net income. After deducting interest from Profit before interest and tax we get profit before tax. If PBT is not specifically given it should be separately ascertained and change in its absolute figures and percentage should be shown in the comparative statement.

Profit after tax: It can be ascertained by deducting tax from before tax. If it is not given it should be determined and change in its absolute figures and percentage be shown in the comparative statement.

How to Prepare Comparative Income Statement?

Step 1: Write the items related with incomes and expenses in Column A one by one.

Step 2: Write the previous year's income statement data in Column B one by one.

Step 3: Write the current year's income statement data in Column C one by one.

Step 4: Find out the absolute change (difference between figure of current year and previous year i.e., Column C – Column B) and write them in Column D one by one.

Step 5: Find out the proportionate change (expressing absolute as percentage of figures of previous year) and write them in Column E one by one.

Illustration 1. *From the following Statement of Profit and Loss of Moon Ltd., for the years ended 31st March 2011 and 2012, prepare a comparative statement of Profit and Loss.*

Particulars	Note No.	2010-11	2011-12
Revenue from operations		*6,00,000*	*10,00,000*
Employee benefits expenses		*2,00,000*	*3,00,000*
Other expenses		*50,000*	*25,000*
Tax Rate 40%			

Solution.

Comparative Statement of Profit and Loss

For the years ended 31st March 2011 and 31st March 2012

	Particulars	2010-11 (₹)	2011-12 (₹)	Absolute Increase/decrease (₹)	Percentage Increase/decrease (%)
I.	**Revenue from Operations**	6,00,000	10,00,000	4,00,000	67
	Less: Expenses:				
II.	**Employee Benefits Expenses**	2,00,000	3,00,000	1,00,000	50
	Other Expenses	50,000	25,000	(25,000)	(50)
III.	**Profit before Tax**	**3,50,000**	**6,75,000**	**3,25,000**	**93**
	Less: Tax 40%	1,40,000	2,70,000	1,30,000	
IV.	**Profit after Tax**	**2,10,000**	**4,05,00**	**1,95,000**	**93**

(B) Comparative Balance Sheet

Comparative Balance Sheet is a statement showing assets and liabilities of the business for two or more accounting periods. It also shows the percentage change in the monetary value of the assets and liabilities. It helps in analysing the financial position of the company in terms of change in the value of assets and liabilities. It is useful for the purpose of showing the comparative value of assets and liabilities.

Format of Comparative Balance Sheet as per schedule III

Format of Comparative Balance Sheet

For the years ended March..... and March ....

	Particulars (A)	Note No.	(B) Previous Year (₹)	(C) Current Year (₹)	(D) = B – C Absolute Increase/ decrease (₹)	(E) = D × 100/B Percentage increase/ decrease (%)
I.	EQUITY AND LIABILITIES					
1.	**Shareholder's Funds**					
	(*a*) Share capital		–	–	–	–
	(*b*) Reserves and surplus		–	–	–	–
	(*c*) Money received against share warrants		–	–	–	–
2.	**Share Application Money Pending Allotment**					
3.	Non-current Liabilities					
	(*a*) Long-term borrowings		–	–	–	–
	(*b*) Deferred tax liabilities (net)		–	–	–	–

Notes

	(*c*) Other long-term liabilities		–	–	–	–
	(*d*) Long-term provisions		–	–	–	–
4.	**Current Liabilities**					
	(*a*) Short-term borrowings		–	–	–	–
	(*b*) Trade payables		–	–	–	–
	(*c*) Other current liabilities		–	–	–	–
	(*d*) Short-term provisions		–	–	–	–
	Total		–	–	–	–
II.	ASSETS					
1.	**Non-current Assets**		–	–	–	–
	(*a*) Fixed assets		–	–	–	–
	(*i*) Tangible assets		–	–	–	–
	(*ii*) Intangible assets		–	–	–	–
	(*iii*) Capital work in progress		–	–	–	–
	(*iv*) Intangible assets under development		–	–	–	–
	(*b*) Non-current investments		–	–	–	–
	(*c*) Deferred tax assets (net)		–	–	–	–
	(*d*) Long-term loans and advances		–	–	–	–
	(*e*) Other non-current assets		–	–	–	–
2.	**Current Assets**					
	(*a*) Current investments		–	–	–	–
	(*b*) Inventories		–	–	–	–
	(*c*) Trade receivables		–	–	–	–
	(*d*) Cash and cash equivalents		–	–	–	–
	(*e*) Short-term loans and advances		–	–	–	–
	(*f*) Other current assets		–	–	–	–
	Total		–	–	–	–

Explanation

The above format is designed as per the new schedule III format introduced by the companies Act, 2013.

How to Prepare Comparative Income Statement?

Step 1: Write the items related with assets, capital and liabilities in Column A one by one

Step 2: Write the previous year's Balance Sheet data in Column A one by one.

Step 3: Write the current year's Balance Sheet data in Column C one by one.

Step 4: Find out the absolute changes (difference between the figure of current year and previous year *i.e.*, Column C – Column B) one by one.

Step 5: Find out the proportionate changes (expressing absolute changes as percentage of figures of previous year) and write them in Column E one by one.

Illustration 2. Convert the following statement of profit and loss into the comparative statement of profit and loss of BCR Co., Ltd.:

Particulars	Note No.	31 March 13	31 March 14
(i) Revenue from Operations		60,00,000	75,00,000
(ii) Other Incomes		1,20,000	1,50,000
(iii) Expenses		50,60,000	44,00,000
(iv) Income Tax		40%	35%

Solution.

Comparative Statement of Profit and Loss

For the years ended March 31, 2013 and 2014

	Particulars	2014	2013	Absolute Increase (+) or decrease (–)	(%) Percentage Increase (+) or decrease (–)
		(₹)	(₹)	(₹)	(₹)
I.	**Revenue from Operations**	75,00,000	60,00,000	15,00,000	25.00
II.	*Add:* Other Incomes	1,20,000	1,50,000	(30,000)	(20.00)
III.	**Total Revenue (I + II)**	76,20,00	61,50,000	14,70,000	23.90
IV.	*Less:* Expenses	50,60,000	44,00,000	6,60,000	15.00
	Profit before Tax	25,60,000	17,50,000	8,10,000	46.29
V.	*Less:* Tax	10,24,000	6,12,500	4,11,500	67.18
	Profit after Tax	15,36,000	11,37,500	3,98,500	35.03

Illustration 3. From the following statement of profit and loss of Madhu Co. Ltd., prepare comparative statement of profit and loss for the year ended March 31, 2013 and 2014:

Particulars	Note No.	31 March 2013 (₹)	31 March 2014 (₹)
Revenue from operations		16,00,000	20,00,000
Employee benefits expenses		8,00,000	10,00,000
Other expenses		2,00,000	1,00,000
Tax Rate 40%			

Solution. Comparative statement of profit and loss of Madhu Co. Ltd., for the year ended March 31, 2013 and 2014:

	Particulars	2014	2013	Absolute Increase (+) or decrease (–)	(%) Percentage Increase (+) or decrease (–)
		(₹)	(₹)	(₹)	(₹)
I.	**Revenue from Operations**	20,00,000	16,00,000	4,00,000	25
II.	*Less:* Expenses				
	(*a*) Employee benefit expenses	10,00,000	8,00,000	2,00,000	25
	(*b*) Other expenses	1,00,000	2,00,000	(1,00,000)	(50)
III	**Profit before Tax (I – II)**	9,00,000	6,00,000	3,00,000	50
IV.	*Less:* Tax @ 40%	3,60,000	2,40,000	1,20,000	50
	Profit after Tax	5,40,000	3,60,000	1,80,000	50

Illustration 4. From the following 'Statement of Profit and Loss' for the year

Notes

ended 31st March, 2013, prepare a 'Comparative Statement of Profit and Loss' of Vidya Ltd.:

Particulars	Note No.	2012-2013 (₹)	2011 – 2012 (₹)
Revenue from operations		*14,00,000*	*11,00,000*
Other Income		*4,00,000*	*3,00,000*
Expenses		*11,00,000*	*12,00,000*

Solution.

Comparative Statement of Profit and Loss of Vidya Ltd.

For the years ended 31st, 2012 and 2013

	Particulars	Note No.	2010-11 (₹)	2011-12 (₹)	Absolute Increase/ decrease	Percentage Increase/ decrease (%)
I.	**Revenue from Operations**		11,00,000	14,00,000	3,00,000	27.27%
	(*a*) *Add* : Other Income		3,00,000	4,00,000	1,00,000	33.33%
II.	**Total Revenue (I + II)**		14,00,000	18,00,000	4,00,000	28.57%
	(*a*) *Less* : Expenses		12,00,000	11,00,000	(1,00,000)	(8.33%)
III.	**Profit before Tax (III – IV)**		2,00,000	7,00,000	5,00,000	250%
	(*a*) Less : Tax @ 50%		1,00,000	3,50,000	2,50,000	250%
IV.	**Profit after Tax (V – VI)**		1,00,000	3,50,000	2,50,000	250%

Illustration 5. *From the following Statement of Profit and Loss of Suntrack Ltd., for the years ended 31st March, 2011 and 2012, prepare a 'Comparative Statement of Profit and Loss'.*

Particulars	Note No.	2011-2012 (₹)	2010 – 2011 (₹)
Revenue from operations		*20,00,000*	*12,00,000*
Other Income		*12,00,000*	*9,00,000*
Expenses		*13,00,000*	*10,00,000*

Solution.

Suntract Ltd.

Comparative Statement of Profit and Loss of Suntrack Ltd.

For the years ended 31st March, 2011 and 2012

	Particulars	2010-11 (₹)	2011-12 (₹)	Absolute Increase/ decrease	Percentage Increase/ decrease (%)
I.	**Revenue from Operations**	12,00,000	20,00,000	8,00,000	66.67
II.	**Other Income**	9,00,000	12,00,000	3,00,000	33.33
III.	**Total Revenue (I + II)**	21,00,000	32,00,000	11,00,000	52.38
IV.	*Less* : Expenses	10,00,000	13,00,000	3,00,000	30.00
V.	**Profit before Tax (III – IV)**	11,00,000	19,00,000	8,00,000	72.72

Illustration 6. *From the following 'Statement of Profit and Loss' for the year ended 31st March, 2013 prepare a 'Comparative Statement of Profit and Loss' of Goods Services Ltd.:*

Particulars	Note No.	2011-2012 (₹)	2010 – 2011 (₹)
Revenue from operations		*20,00,000*	*15,00,000*
Other Income		*10,00,000*	*4,00,000*
Expenses		*21,00,000*	*15,00,000*

Rate of Income tax was 50%

Solution.

Comparative Statement of Profit and Loss

For the years ended 31st March, 2012 and 2013

	Note No.	2014	2013	Absolute Increase/ decrease	Percentage Increase / decrease
		(₹)	(₹)	(₹)	(₹)
Revenue from Operations		15,00,000	20,00,000	5,00,000	33.33%
Add: Other Incomes		4,00,000	10,00,000	6,00,000	150%
Total Revenue		19,00,000	30,00,000	11,00,000	57.89%
Less: Expenses		15,00,000	21,00,000	6,00,000	40%
Profit before Tax		4,00,000	9,00,000	5,00,000	125%
Less: Tax @ 50%		2,00,000	4,50,000	2,50,000	125%
Profit after Tax		2,00,000	4,50,000	2,50,000	125%

Illustration 7. *From the following Statement of Profit and Loss of Moontrack Ltd., for the years ended 31st March 2011 and 2012, prepare a 'Comparative Statement of Profit and Loss'.*

Particulars	*Note No.*	*2011-2012 (₹)*	*2010 – 2011 (₹)*
Revenue from operations		*40,00,000*	*24,00,000*
Other Income		*24,00,000*	*18,00,000*
Expenses		*16,00,000*	*14,00,000*

Solution.

Comparative Statement of Profit and Loss

For the years ended 31st March, 2011 and 2012

	2014	2013	Absolute Increase/decrease	Percentage Increase /decrease
	(₹)	(₹)	(₹)	(₹)
Revenue from Operations	24,00,000	40,00,000	16,00,000	66.67
Other Incomes	18,00,000	24,00,000	6,00,000	33.33
Total Revenue	42,00,000	64,00,000	22,00,000	52.38
Less: Expenses	14,00,000	16,00,000	2,00,000	14.28
Profit before Tax	28,00,000	48,00,000	20,00,000	71.42

Illustration 8. *Following information is extracted from the statement of Profit and Loss for the years ended 31st March, 2012 and 2013. Prepare a Comparative Statement of Profit and Loss:*

Notes

Particulars,	Note No.	31 March 2013 (₹)	31 March 2013 (₹)
Revenue from operations		40,00,000	32,00,000
Employee benefits expenses		20,00,000	16,00,000
Other expenses		2,00,000	4,00,000
Tax Rate		40%	40%

Solution.

Comparative Statement of Profit and Loss

For the years ended 31st March, 2012 and 2013

	Particulars	2012 (₹)	2013 (₹)	Absolute Increase/decrease	Percentage Increase/decrease (%)
I.	**Revenue from Operations**	32,00,000	40,00,000	8,00,000	25%
II.	**Total Revenue**	32,00,000	40,00,000	8,00,000	25%
III.	**Expenses**				
	Employee's Benefit Expenses	16,00,000	20,00,000	4,00,000	25%
	Other Expenses	4,00,000	2,00,000	(2,00,000)	(50%)
	Total Expenses	20,00,000	22,00,000	2,00,000	10%
IV.	**Profit before Tax**	12,00,000	18,00,000	6,00,000	50%
V.	**Less: Tax**	41,80,000	7,20,000	2,40,000	50%
VI.	**Profit after Tax**	7,20,000	10,80,000	3,60,000	50%

Illustration 9. *Prepare a Comparative Statement of Profit and Loss from the following details:*

Particulars	Note No.	31-03-2013 (₹)	31-03-2012 (₹)
Revenue from operations		₹ 30,00,000	₹ 20,00,000
Other Income (% of Revenue from operations)		15%	20%
Expenses (% of Revenue from operations)		60%	50%

Solution. (*a*)

Comparative Statement of Profit and Loss

For the years ended 31st March, 2011 and 2012

	Particulars	Note No.	31-03-2012 (₹)	31-03-2013 (₹)	Absolute Increase/ decrease (₹)	Percentage Increase/ decrease (%)
	1		2	3	4	5
			A	B	(B – A) = C	$\frac{C}{A} \times 100 = D$
I.	**Revenue from Operations**		20,00,000	30,00,000	10,00,000	50
II.	**Other Income**		4,00,000	4,50,000	50,000	12.5
III.	**Total Revenue (I + II)**		24,00,000	34,50,000	10,50,000	43.75
IV.	**Expenses**		10,00,000	18,00,000	8,00,000	80
V.	**Profit before Tax (III-IV)**		14,00,000	16,50,000	2,50,000	17.85

From the following statement of Profit and Loss of Star Ltd. for the years ended 31st March 2011 and 2012 prepare a comparative statement of Profit and Loss

Particulars	*Note No.*	*31-03-2012 (₹)*	*31-03-2011 (₹)*
Revenue from operations		20,00,000	16,00,000
Employee benefits expenses		10,00,000	8,00,000
Other expenses		1.00,000	2,00,000
Tax		50%	50%

(*b*)

Comparative Statement of Profit and Loss

For the years ended 31st March, 2011 and 2012

	Particulars	*Note No.*	*31-03-2012 (₹)*	*31-03-2013 (₹)*	*Absolute Increase/ decrease (₹)*	*Percentage Increase/ decrease (%)*
	1		2	3	4	5
			A	B	(B – A) = C	$\frac{C}{A} \times 100 = D$
I.	**Revenue from Operations**		16,00,000	20,00,000	4,00,000	25
II.	**Less: Expenses**					
	Employee benefit expenses		8,00,000	10,00,000	2,00,000	25
	Other Expenses		2,00,000	1,00,000	(1,00,000)	(50)
III.	**Total Expenses**		10,00,000	11,00,000	1,00,000	10
IV.	**Profit before tax (I – III)**		6,00,000	9,00,000	3,00,000	50
V.	**Tax**		3,00,000	4,50,000	1,50,000	50
VI.	**Profit after tax**		3,00,000	4,50,000	1,50,000	50

Illustration 10. *From the following Balance Sheet of Shahnaz Shahab Limited as on 31st March 2011 and 2012, prepare a Comparative Balance Sheet:*

	Particulars	*Note No.*	*2010–11*	*2011–12*
	EQUITY AND LIABILITIES			
1.	***Shareholders Funds***			
	(a) Share Capital		*21,00,000*	*29,00,000*
	(b) Reserves and surplus		*10,00,000*	*12,00,000*
2.	***Non-current Liabilities***			
	Long-term borrowings		*12,00,000*	*18,00,000*
3.	***Current Liabilities***			
	Trade payables		*8,00,000*	*12,00,000*
	Total		***51,00,000***	***71,00,000***
	ASSETS			
1.	***Non-current Assets***			
	Fixed Assets			
	(i) Tangible assets		*21,00,000*	*29,00,000*
	(ii) Intangible assets		*12,00,000*	*18,00,000*

Notes

2. *Current Assets*			
(a) Inventories		*10,00,000*	*12,00,000*
(b) Cash and cash equivalents		*8,00,000*	*12,00,000*
		51,00,000	***71,00,000***

Solution.

Shahnaz Shahab Ltd.

Comparative Balance Sheet

For the years ended on 31st March 2011 and 31st March 2012

Particulars	*Note No.*	*2010–11*	*2011–12*	*Absolute increase/decrease (₹)*	*Percentage increase/decrease (%)*
EQUITY AND LIABILITIES					
1. **Shareholders Funds**					
(*a*) Share Capital		21,00,000	29,00,000	8,00,000	38
(*b*) Reserves and surplus		10,00,000	12,00,000	2,00,000	20
2. **Non-current Liabilities**					
Long-term borrowings		12,00,000	18,00,000	6,00,000	50
3. **Current Liabilities**					
Trade payables		8,00,000	12,00,000	4,00,000	50
Total		**51,00,000**	**71,00,000**	**20,00,000**	**39**
ASSETS					
1. **Non-current Assets**					
Fixed Assets					
(*i*) Tangible assets		21,00,000	29,00,000	8,00,000	38
(*ii*) Intangible assets		12,00,000	18,00,000	6,00,000	50
2. **Current Assets**					
(*a*) Inventories		10,00,000	12,00,000	2,00,000	20
(*b*) Cash and cash equivalents		8,00,000	12,00,000	4,00,000	50
		51,00,000	**71,00,000**	**20,00,000**	**39**

Note. *Figure in bracket are negative*

Assets have been classified as Non-current and Current Assets.

In the same way, liabilities have been classified as shareholder's fund, current and non-current liabilities.

Illustration 11. *From the following Balance Sheet of Balaji Traders as 31st March 2011 and 2012, prepare a Comparative Balance Sheet:*

Particulars	*Note No.*	*2010–11*	*2011–12*
EQUITY AND LIABILITIES			
1. ***Shareholders Funds***			
(a) Share Capital		*10,00,000*	*12,00,000*
(b) Reserves and surplus		*1,00,000*	*1,10,000*
2. ***Non-current Liabilities***			

	Long-term borrowings		*6,00,000*	*7,00,000*
	Other long-term borrowings		*1,50,000*	*1,30,000*
	Long-term provisions		*25,000*	*20,000*
3.	***Current Liabilities***			
	Trade payables		*80,000*	*1,00,000*
	Short-term provisions		*15,000*	*18,000*
	Total		***19,70,000***	***22,78,000***
	ASSETS			
1.	***Non-current Assets***			
	Fixed Assets			
	(i) Tangible assets		*14,95,000*	*17,21,000*
	(ii) Intangible assets		*1,20,000*	*1,50,000*
	Capital work in progress		*80,000*	*90,000*
2.	***Current Assets***			
	(a) Inventories		*50,000*	*45,000*
	(b) Cash and cash equivalents		*35,000*	*42,000*
	(c) Current investments		*1,00,000*	*1,20,000*
	(d) Trade receivables		*90,000*	*1,10,000*
	Total		***19,70,000***	***22,78,000***

Solution.

Balaji Traders

Comparative Balance Sheet

For the years ended on 31st March 2012 and 31st March 2013

	Particulars	Note No.	2010–12 (₹)	2011–13 (₹)	Absolute increase/decrease (₹)	Percentage increase/ decrease (%)
	EQUITY AND LIABILITIES					
1.	**Shareholders Funds**					
	(*a*) Share Capital		10,00,000	12,00,000	2,00,000	20
	(*b*) Reserves and surplus		1,00,000	1,10,000	10,000	10
2.	**Non-current Liabilities**					
	(*a*) Long-term borrowings		6,00,000	7,00,000	1,00,000	17
	(*b*) Other long-term borrowings		1,50,000	1,30,000	(20,000)	(13)
	(*c*) Long-term provisions		25,000	20,000	(5,000)	(20)
3.	**Current Liabilities**					
	(*a*) Trade payables		80,000	1,00,000	20,000	25
	(*b*) Short-term provisions		15,000	18,000	3,000	20
	Total		**19,70,000**	**22,78,000**	**3,08,000**	**16**
	ASSETS					
1.	**Non-current Assets**					

Notes

(a) Fixed Assets					
(i) Tangible assets		14,95,000	17,21,000	2,26,000	15
(ii) Intangible assets		1,20,000	1,50,000	30,000	25
(b) Capital work in progress		80,000	90,000	10,000	13
2. Current Assets					
(a) Inventories		50,000	45,000	(5,000)	(10)
(b) Cash and cash equivalents		35,000	42,000	7,000	20
(c) Current investments		1,00,000	1,20,000	20,000	20
(d) Trade receivables		90,000	1,10,000	20,000	22
Total		19,70,000	22,78,000	3,08,000	16

Note. *Figures in the brackets are negative.*

Illustration 12. *The followings are the excerpts of balance sheets of J. Ltd., for the year ended March 31, 2013 and 2014. Prepare a Comparative balance sheet and comment on the financial position of the business firm.*

Particulars	*Note No.*	*2014 (₹)*	*2013 (₹)*
I. *EQUITY AND LIABILITIES*			
1. *Shareholders Funds*			
(a) Share Capital		*20,00,000*	*15,00,000*
(b) Reserves and surplus		*3,00,000*	*4,00,000*
2. *Non-current Liabilities*			
(a) Long-term borrowings		*9,00,000*	*6,00,000*
3. *Current Liabilities*			
(a) Trade payables		*3,00,000*	*2,00,000*
Total		***35,00,000***	***27,00,000***
II. *ASSETS*			
1. *Non-current Assets*			
(a) Fixed Assets			
– Tangible assets		*20,00,000*	*15,00,000*
– Intangible assets		*9,00,000*	*6,00,000*
2. *Current Assets*			
(a) Current assets		*3,00,000*	*4,00,000*
– Inventories		*3,00,000*	*2,00,000*
– Cash and cash equivalents			
Total		***35,00,000***	***27,00,000***

Solution

Comparative Balance Sheet

as a March 2013 and March 2014 *(Figure in Lakhs)*

Particulars	*2014*	*2013*	*Absolute Change*	*Percentage Change (%)*
I. **EQUITY AND LIABILITIES**				
1. **Shareholders Funds**				
(*a*) Share Capital	20	15	05	33.33
(*b*) Reserves and surplus	03	04	01	(25)
2. **Non-current Liabilities**				
(*a*) Long-term borrowings	09	06	3	50
3. **Current Liabilities**				
(*a*) Trade payables	03	02	01	50
Total	35	27	08	29.63
II. **ASSETS**				
1. **Non-current Assets**				
(*a*) Fixed Assets				
(*i*) Tangible assets	20	15	05	33.33
(*ii*) Intangible assets	09	06.	03	50
2. **Current Assets**				
(*a*) Inventories	03	04	(01)	(25)
(*b*) Cash and cash equivalents	03	02	01	50
Total	35	27	08	29.63

4.8. Common Size Statements

Convenient comparison of the financial statements requires that the financial statement should be converted into common size statements. Every item of the statement is presented in the form of percentage of its important heading. Every item of income statement is expressed in terms of the percentage of the total sales. In the same way every asset is expressed in terms of the percentage of total assets and every liability is expressed in terms of the percentage of total liability.

Common Size Balance Sheet

Common Size Balance Sheet refers to the statement which shows the assets and liabilities of the business in percentage terms to enable better comparison of the value of assets and liabilities over two or more accounting periods. It is useful to analyse the increasing or decreasing trend of the assets and liabilities as compared with the previous period from current period.

How to Prepare Common Size Balance Sheet?

Step 1: Pick up the items of assets, liabilities and capital and write them in Column A.

Step 2: Pick up the absolute amounts of assets, liabilities and capital of **current years's Balance Sheet** and write them in Column C.

Notes

Step 3: Pick up the absolute amounts of assets, liabilities and capital of **previous year's Balance Sheet** and write them in Column C.

Step 4: Calculate the percentage of different items of **previous year's Balance Sheet to total liabilities of previous year** and write them in Column D.

Step 5: Calculate the percentage of different items of current year's Balance Sheet to total liabilities of the current year and write them in Column E.

Illustration 13. From the following Balance Sheet of Rashmi Mills Ltd., prepare the common size balance sheet for the year ended March 31st 2011 and March 31st 2012

Particulars	*Note No.*	*2010–11 (₹)*	*2011–12 (₹)*
EQUITY AND LIABILITIES			
1. ***Shareholders Funds***			
(a) Share Capital		*24,00,000*	*30,50,000*
(b) Reserves and surplus		*13,00,000*	*13,50,000*
2. ***Non-current Liabilities***			
Long-term borrowings		*15,00,000*	*19,50,000*
3. ***Current Liabilities***			
Trade payables		*11,00,000*	*12,00,000*
Total		***63,00,000***	***75,50,000***
ASSETS			
1. ***Non-current Assets***			
Fixed Assets			
(i) Tangible assets		*24,00,000*	*30,50,000*
(ii) Intangible assets		*15,00,000*	*19,50,000*
2. ***Current Assets***			
(a) Inventories		*13,00,000*	*13,50,000*
(b) Cash and cash equivalents		*11,00,000*	*12,00,000*
Total		***63,00,000***	***75,50,000***

Solution.

Common Size Balance Sheet

For the years ended on 31st March 2011 and March 2012

Particulars	*Note No.*	*2010–11 (₹)*	*2011–12 (₹)*	*Percentage of total 2010–11*	*Percentage of total 2011–12*
EQUITY AND LIABILITIES					
1. Shareholders Funds					
(*a*) Share Capital		24,00,000	30,50,000	38	40
(*b*) Reserves and surplus		13,00,000	13,50,000	21	18

2. **Non-current Liabilities**					
Long-term borrowings		15,00,000	19,50,000	24	26
3. **Current Liabilities**					
Trade payables		11,00,000	12,00,000	17	16
Total		**63,00,000**	**75,50,000**	**100**	**100**
ASSETS					
1. **Non-current Assets**					
Fixed Assets					
(*i*) Tangible assets		24,00,000	30,50,000	38	40
(*ii*) Intangible assets		15,00,000	19,50,000	24	26
2. **Current Assets**					
(*a*) Inventories		13,00,000	13,50,000	21	18
(*b*) Cash and cash equivalents		11,00,000	12,00,000	17	16
Total		**63,00,000**	**75,50,000**	**100**	**100**

Working Notes

Calculation of Percentage

Assets	**2010-11**	**2011-12**
Share capital	$\frac{24,00,000}{63,00,000} \times 100 = 38\%$	$\frac{30,50,000}{75,50,000} \times 100 = 40\%$
Reserve and surplus	$\frac{13,00,000}{63,00,000} \times 100 = 21\%$	$\frac{13,50,000}{75,50,000} \times 100 = 18\%$
Long-term borrowings	$\frac{15,00,000}{63,00,000} \times 100 = 24\%$	$\frac{19,50,000}{75,50,000} \times 100 = 26\%$
Trade payables	$\frac{11,00,000}{63,00,000} \times 100 = 17\%$	$\frac{12,00,000}{75,50,000} \times 100 = 16\%$
Tangible assets	$\frac{24,00,000}{63,00,000} \times 100 = 38\%$	$\frac{30,50,000}{75,50,000} \times 100 = 40\%$
Inventories	$\frac{13,00,000}{63,00,000} \times 100 = 21\%$	$\frac{13,50,000}{75,50,000} \times 100 = 18\%$
Cash and cash equivalents	$\frac{11,00,000}{63,00,000} \times 100 = 17\%$	$\frac{12,00,000}{75,50,000} \times 100 = 16\%$

Common Size Income Statement

Common Size Income Statement is known as common size because it is converted to a common variable indicated by percentage. "Common size income statement refers to the income statement for two or more accounting period on the basis of which income and expenses are shown in percentage terms." It helps in comparing the relative value of income and expenses over two or more accounting periods. Financial managers prepare these common size statements for business reporting and decision making purposes.

Notes

Format of Common-size Statement of Profit and Loss

For the years ended March..... and March ....

	Particulars (A)	Note No. (B)	Absolute Amount: Figure at the end of Current reporting Period (C) (₹)	Absolute Amount: Figure at the end of Previous reporting Period (D) (₹)	Percentage of Revenue from Operations: Current reporting period (%) (E)	Percentage of Revenue from Operations: Previous reporting period (%) (F)
I.	**Revenue from Operations**		—	—	100	100
II.	**Other Income**		—	—	—	—
III.	**Total Revenue (I + II)**		—	—	—	—
IV.	**Expenses**		—	—	—	—
	Cost of Materials Consumed		—	—	—	—
	Purchases of Stock-in-Trade		—	—	—	—
	Changes in inventories of Finished Goods		—	—	—	—
	Work-in-Progress and Stock-in-Trade		—	—	—	—
	Employees Benefits Expenses		—	—	—	—
	Finance Costs		—	—	—	—
	Depreciation and Amortization Expenses		—	—	—	—
	Other Expenses		—	—	—	—
			—	—	—	—
	Total Expenses		—	—	—	—
V.	**Profit before Tax (III – IV)**		—	—	—	—
VI.	**Tax**		—	—	—	—
VII.	**Profit after Tax (V – VI)**		—	—	—	—
	(*d*) Cash and cash equivalents		–	–	–	–
	(*e*) Short-term loans and advances		–	–	–	–
	(*f*) Other current assets		–	–	–	–
	Total		–	–	–	–

How to Prepare Common Size Income Statement?

Step 1: Pick up the items of income statement and write them in Column A.

Step 2: Write the current year's income statement data in Column C.

Step 3: Write the previous year's income statement data in Column D.

Step 4: Calculate the percentage relation of current year's income statement data to net sales of current year and write it in Column E.

Step 5: Calculate the percentage relation of previous year's income statement data to net sales of the previous year and write it in Column F.

In order to make such common size income statement sales is supposed to be

100 and every item of the income statement is expressed in terms of percentage of total sales.

Illustration 14. *Prepare common-size balance sheet of XRI Ltd., from the following information:*

Notes

Particulars	*Note No.*	*March 31, 2014 (₹)*	*March 31, 2013 (₹)*
I. ***EQUITY AND LIABILITIES***			
1. ***Shareholders Funds***			
(a) Share Capital		*20,00,000*	*12,00,000*
(b) Reserves and surplus		*5,00,000*	*5,00,000*
2. ***Non-current Liabilities***			
(a) Long-term borrowings		*6,00,000*	*5,00,000*
3. ***Current Liabilities***			
(a) Trade payables		*15,50,000*	*10,50,000*
Total		***41,50,000***	***32,50,000***
II. ***ASSETS***			
1. ***Non-current Assets***			
(a) Fixed Assets			
– Tangible assets			
Plant and machinery		*15,00,000*	*10,00,000*
– Intangible assets			
Goodwill		*15,00,000*	*10,00,000*
(b) Non-current investments		*10,00,000*	*10,00,000*
2. ***Current Assets***			
(a) Inventories		*1,50,000*	*2,50,000*
Total		***35,00,000***	***27,00,000***

Solution

Common-size Balance Sheet of XRI Lt

For the year ended March 31, 2013 and March 31, 2014

Particulars	*Absolute Amounts*		*Percentage of Net Sales*	
	31-3-2014	*31-03-2013*	*31-03-2014 (%)*	*31-03-2013 (%)*
I. **EQUITY AND LIABILITIES**				
1. **Shareholders Funds**				
(*a*) Share Capital	15,00,000	12,00,000	36,14	36.93
(*b*) Reserves and surplus	5,00,000	5,00,000	12.05	15.38
2. **Non-current Liabilities**				
(*a*) Long-term borrowings	6,00,000	5,00,000	14.46	15.38

Notes

3. Current Liabilities				
(a) Trade payables	15,50,000	10,50,000	37.35	32.31
Total	41,50,000	32,50,000	100	1000
II. ASSETS				
1. Non-current Assets				
(a) Fixed Assets				
– Tangible assets				
Plant & machinery	14,00,000	8,00,000	33.73	24.61
– Intangible assets				
Goodwill	16,00,000	12,00,000	38.55	36.92
2. Non-current Investments				
(a) Current assets	10,00,000	10,00,000	24.10	30.77
– Inventories	1,50,000	2,50,000	3.62	7.69
Total	41,50,000	32,50,000	100	100

Illustration 15. *From the following Income Statement of ABC Ltd., prepare the common size income statement for the year ended March 31st 2013 and March 31st 2014.*

	Particulars	2012-13 (₹)	2013-14 (₹)
I.	**Revenue from Operations**	15,00,000	18,00,000
II.	**Expenses**		
	Purchases of Stock-in-Trade	7,05,000	7,92,000
	Changes in inventories of Finished Goods	1,05,000	72,000
	Employees Benefits Expenses	4,05,000	5,04,000
	Finance Costs	75,000	54,000
	Depreciation and Amortization Expenses	15,000	18,000
	Other Expenses	45,000	36,000
	Total Expenses	13,50,000	14,76,000
III.	**Profit before Tax (I – II)**	1,50,000	3,24,000
IV.	**Tax @ 35%**	52,500	1,13,400
V.	**Profit after Tax (III – IV)**	97,500	2,10,600

Solution.

	Particulars	2012-13 (₹)	2013-14 (₹)	Percentage of Total 2012-13 (₹)	Percentage of Total 2013-14 (₹)
I.	**Revenue from Operations**	15,00,000	18,00,000	100	100
II.	Expenses				
	Purchases of Stock-in-Trade	7,05,000	7,92,000	47	44
	Changes in inventories of Finished Goods	1,05,000	72,000	7	4
	Employees Benefits Expenses	4,05,000	5,04,000	27	28
	Finance Costs	75,000	54,000	5	3

	Depreciation and Amortization Expenses	15,000	18,000	1	1
	Other Expenses	45,000	36,000	3	2
	Total Expenses	13,50,000	14,76,000	90	82
III.	**Profit before Tax (I – II)**	1,50,000	3,24,000	10	18
IV.	Tax @ 35%	52,500	1,13,400	3.5	6.3
V.	**Profit after Tax (III – IV)**	97,500	2,10,600	6.5	11.7

Illustration 16. *From the following Income Statements of Kejriwal Ltd., prepare the common size income statement for the year ended March 31st 2014 and March 31st 2015.*

	Particulars	*2013–14 (₹)*	*2014–15 (₹)*
I.	***Revenue from Operations***	*15,00,000*	*18,00,000*
II.	***Other Income***	*3,00,000*	*2,70,000*
III.	***Total Revenue (I + II)***	*18,00,000*	*20,70,000*
IV.	***Expenses***		
	Cost of Materials Consumed	*3,00,000*	*4,50,000*
	Purchases of Stock-in-Trade	*2,70,000*	*1,80,000*
	Changes in inventories of Finished Goods		
	Work-in-Progress and Stock-in-Trade	*75,000*	*36,000*
	Employees Benefits Expenses	*2,25,000*	*3,24,000*
	Finance Costs	*2,40,000*	*2,52,000*
	Depreciation and Amortization Expenses	*30,000*	*1,80,000*
	Other Expenses	*75,000*	*90,000*
	Total Expenses	*12,15,000*	*15,12,000*
V.	***Profit before Tax (III – IV)***	*5,85,000*	*5,58,000*
VI.	***Tax @ 35%***	*2,04,750*	*1,95,300*
VII.	***Profit after Tax (V – VI)***	*3,80,250*	*3,62,700*

Solution.

	Particulars	2013–14 (₹)	2014–15 (₹)	Percentage of Total 2013–14 (₹)	Percentage of Total 2014–15 (₹)
I.	**Revenue from Operations**	15,00,000	18,00,000	100	100
II.	**Other Income**	3,00,000	2,70,000	20	15
III.	**Total Revenue (I + II)**	18,00,000	20,70,000	120	115
IV.	**Expenses**				
	Cost of Materials Consumed	3,00,000	4,50,000	20	25
	Purchases of Stock-in-Trade	2,70,000	1,80,000	18	10
	Changes in inventories of Finished Goods				
	Work-in-Progress and Stock-in-Trade	75,000	36,000	5	2
	Employees Benefits Expenses	2,25,000	3,24,000	15	18

Notes

	Finance Costs	2,40,000	2,52,000	16	14
	Depreciation and Amortization Expenses	30,000	1,80,000	2	10
	Other Expenses	75,000	90,000	5	5
	Total Expenses	12,15,000	15,12,000	81	84
V.	**Profit before Tax (III – IV)**	5,85,000	5,58,000	39	31
VI.	**Tax @ 35%**	2,04,750	1,95,300	13.65	10.85
VII.	**Profit after Tax (V – VI)**	3,80,250	3,62,700	25.36	2015

Illustration 17. *From the following statement of Profit and Loss of Star Ltd., fro the year ended 31st March 2012. Prepare a common Size Statement of Profit and Loss.*

Particulars	**Note No.**	**31-03-2012 (₹)**
Revenue from Operations		*20,00,000*
Employee benefit expenses		*10,00,000*
Other Expenses		*1,00,000*

Solution.

Common Size Statement of Profit and Loss

For the year ended 31, March , 2012

	Particulars	*Note No.*	*Absolute Amount (₹)*	*Percentage of Revenu from Operations*
			2011-12	*2011-12*
I.	**Revenue from Operations**		20,00,000	100
II.	**Employee benefit expenses**		10,00,000	50
	Other Expenses		1,00,000	5
III.	**Total Expenses**		11,00,000	55
IV.	**Profit before Tax (I – III)**		9,00,000	45

4.9. Test Problems

1. The following information is extracted from the book of Confident Co. Ltd. You are required to rearrange the information for Financial Analysis and calculate (1) Return on investment (ROI) (2) Return on capital employed (3) Return on shareholder's funds (4) Return on equity shareholder's (5) Return on total assets.

Particulars	₹	*Particulars*	₹
Net Sales	10,00,000	Profit & Loss Account	2,00,000
Cost of goods sold	6,00,000	Debentures	2,50,000
Interest on debentures	25,000	Sundry creditors	50,000
Loss on sale of furniture	5,000	Equity share capital	3,00,000
Interest on govt. securities	5,000	10% pref. share capital	2,00,000
Fixed assets less depreciation	10,75,000	Operating expenses	1,50,000

Investment in govt. securities	50,000	Provision for tax	75,000
Current assets	5,00,000		
Reserves	4,00,000		

[**Ans.** (1) 17.24%, (2) 12%, (3) 12.62%, (4) 10.77%]

Notes

2. Calculate the earnings per share from the following information:

Net Profit before tax	₹ 10,00,000
Tax on profit	₹ 50%
15% preference share capital (₹ 10 each)	₹ 2,00,000
Equity share capital 4,700 shares of ₹ 10 each	₹ 4,70,000

[Ans. ₹ 100 per share]

3. Profit and Loss Account of X Ltd., is given below

Profit and Loss Account

Particulars	₹	*Particulars*	₹
To Opening stock	2,00,000	By sales	16,00,000
To Purchases	12,00,000	By Closing stock	3,20,000
To Administration expenses	1,20,000	By Dividend	4,000
To Selling expenses	80,000		
To Financial expenses	40,000		
To Loss on sale of assets	5,000		
To Net profit	2,79,000		
	19,24,000		**19,24,000**

Calculate the Profitability Ratios

[**Ans.** (1) G.P: 32.5%, (2) N.P: 17.44%, (3) OP: 20%, (4) OP Ratio: 80%]

4. (*a*) From the following details of a trader you are required to calculate stock turnover ratio.

	₹
Sales	39,984
Sales returns	380
Opening stock at cost	1,378
Closing stock at cost	1,814
Total Gross profit for the year	8,068

(*b*) Calculate stock turnover ratio and Stock turnover period from the following sales ₹ 10,000,000; Gross profit ratio 20%; Stock at the beginning of the year ₹ 1,75,000; Stock at the end of the year ₹ 1,45,000

[**Ans.** (1) 19.76 Times (2) 2.4 months]

5. Ganesh Bros. sells goods on cash and credit terms and also purchased goods on cash and credit terms. The following particulars are obtained from their books.

	₹
Total sales	5,00,000
Cash sales	40,000
Sales returns	20,000
Debtors at the end	80,000
Bills receivable at the end	20,000
Reserve for doubtful debts	1,000
Total purchases	3,00,000
Cash purchases	50,000
Purchase returns	10,000
Creditors at the end	60,000
Bills payable at the end	20,000
Reserve for discount on creditors	2,000
Opening stock	50,000
Closing stock	40,000
Gross profit	1,00,000
Fixed assets	10,00,000

Calculate activity ratio (turnover ratio)

[**Ans.** (1) 8.44 Stock Turnover Ratio; (2) 0.48 Times Fixed Asset Turnover Ratio; (3) 4.4 Debtors Turnover Ratio; (4) 83 Debtors Collection Period; (5) 2 Times A/c Payable; (6) 122 A/c Payable Period]

6. You are given the following information

	₹
Cash	18,000
Debtors	1,42,000
Closing Stock	1,80,000
Bills Payable	27,000
Creditors	50,000
Outstanding expenses	15,000
Tax payable	75,000

Calculate: (*a*) Current ratio (*b*) Liquidity ratio (*c*) Absolute liquidity ratio.

[**Ans.** (1) 2.036 Times, (2) 0.96, (3) 0.11]

7. From the following Balance Sheet of Balaji Industries Ltd., you are required to calculate debt equity ratio.

Balance Sheet

As at 31.12.1999

Liabilities	₹	*Assets*	₹
Share capital		Fixed assets	1,20,000
10,000 shares of ₹ 10 each	1,00,000	Current assets	80,000
General reserve	12,000		
P & L A/c	8,000		
Debentures	30,000		
Current liabilities	50,000		
	2,00,000		**2,00,000**

[**Ans.** 0.67]

8. Balance Sheet of Rama Ltd. as at 31.12.1993 is as follows:

Liabilities	₹	*Assets*	₹
Equity capital	2,00,000	Fixed assets	3,60,000
9% Preference share capital	1,00,000	Stock	50,000
8% Debentures	1,00,000	Debtors	1,10,000
Profit and Loss A/c	40,000	Bills Receivable	6,000
Creditors	90,000	Bank balance	4,000
	5,30,000		**5,30,000**

Find out: (1) Fixed assets ratio and (2) Capital gearing ratio.

[**Ans.** (1) 0.81 (2) 0.833]

9. Given below is the summarized Balance Sheet and Profit and Loss of Ragunath Sugar Mills Ltd. as on 31.12.2007. You are required to calculate.

1. Current ratio
2. Quick ratio
3. Fixed assets ratio
4. Debt equity ratio
5. Proprietary ratio
6. Stock turnover ratio
7. Fixed assets turnover ratio
8. Return on capital employed
9. Debtors turnover ratio
10. Creditors turnover ratio
11. Net profit ratio
12. Operating ratio

Balance Sheet

As at 31.12.1999

Liabilities	₹	*Assets*	₹
Share capital		Land and building	30,00,000
40,000 shares of ₹ 10 each	40,00,000	Plant & Machinery	16,00,000
Reserves	18,00,000	Stock	29,60,000
Creditors	26,00,000	Debtors	14,20,000
Profit & Loss Account	6,00,000	Cash at bank	6,20,000

Notes

6% Debentures	6,00,000		
	96,00,000		**96,00,000**

Profit and Loss Account for the year ended on 31.12.2007

Particulars	₹	*Particulars*	₹
To Opening stock	19,90,000	By sales	1,70,00,000
To Purchases	1,09,05,000	By Closing stock	29,80,000
To Direct expenses	2,85,000		
To Gross profit	68,00,000		
	1,99,80,000		**1,99,80,000**
To Administration expenses	30,00,000	By Gross profit b/d	68,00,000
To Selling & Distribution exp.	6,00,000	By Non-operating income	1,80,000
To Financial expenses	3,00,000		
To Other non-operating exp.	80,000		
To Net profit	30,00,000		
	69,80,000		**69,80,000**

[**Ans.** (1) 1.92, (2) 0.78, (3) 0.66, (4) 0.67, (6) 4.10 times, (7) 3.69 times, (8) 45.71%, (9) 11.97 times, (10) 4.19 times (11) 17.64%, (12) 81.17%]

10. Find out fixed assets and gross profit from the following information:

    Sales ₹ 10,00,000

    Gross profit ratio 25%

    Fixed assets turnover (on cost of sales) 5 times

    [**Ans.** ₹ 1,50,000]

11. Given:

    Current assets = 2.8

    Acid-test ratio = 1.5

    Working capital = ₹ 1,62,000

    Calculate:

    1. Current
    2. Current liabilities
    3. Liquid assets
    4. Stock

    [**Ans.** (1) ₹ 2,52,000, (2) ₹ 90,000, (3) ₹ 1,35,000 (4) ₹ 1,17,000]

12. Following are the ratios relating to the trading activities of Nagul Trader Ltd., Madras

    Receivable turnover = 90 days

    Inventory turnover = 3 times

    Payable turnover = 3 months

    Gross profit ratio = 25%

    Gross profit for the amounted to ₹ 18,000, closing inventory of the year is ₹ 2,000 above the opening inventory. Bill Receivable amount to ₹ 2,500 and Bills Payable ₹ 1,00. Ascertain the following:

1. Sales
2. Debtors
3. Closing inventory and
4. Sundry creditors.

[**Ans.** (1) ₹ 72,000, (2) ₹ 1550 Debtors, (3) 19,000, (4) 13,000]

Notes

13. The following figures are extracted from the Balance Sheet of X Ltd. As on 31st December:

Particulars	*1992* ₹	*1993* ₹
Stock	25,000	40,000
Debtors	10,000	16,000
Cash at Bank	5,000	4,000
Creditors	8,000	15,000
Bills Payable	2,000	3,000
Provision for Taxes	5,000	7,000
Bank Overdraft	5,000	15,000

Calculate the Current ratio and Quick ratio for two years.

[**Ans.** (1) Current ratio, (2) Quick ratio 1992 - 2 times, 1992 - 0.75, 1993 - 1.5 times, 1993 - 0.50]

14. From the following particulars, pertaining to assets and liabilities of a company calculate (*a*) liquid ratio, (*b*) proprietary ratio, (*c*) debt equity ratio, and (*d*) capital gearing ratio.

Liabilities	₹	*Assets*	₹
5,000 equity shares of ₹ 50 each	2,50,000	Building	3,00,000
1,000 8% preference shares of ₹ 100 each	1,00,000	Machinery	2,50,000
2,000 9% Debentures of ₹ 100 each	2,00,000	Stock	1,20,000
Reserves	1,50,000	Debtors	1,00,000
Creditors	75,000	Cash at Bank	27,500
Bank Overdraft	25,000	Prepaid expenses	2,500
	8,00,000		**8,00,000**

[**Ans.** (1) Current ratio, (2) Quick ratio 1992 - 2 times, 1992 - 0.75, 1993 - 1.5 times, 1993 - 0.50]

15. Following is the Balance Sheet of Kovalan & Co. Ltd.

Liabilities	₹	*Assets*	₹
Equity shares capital	1,00,000	Cash	2,000
6% Preference share capital	1,00,000	Bank	10,000
7% Debentures	40,000	Bills Receivable	30,000

Notes

8% Public debt	20,000	Investments	20,000
Bank overdraft	40,000	Debtors	70,000
Creditors	60,000	Stock	40,000
Outstanding creditors	7,000	Furniture	30,000
Proposed dividend	10,000	Machinery	1,00,000
Reserves	1,50,000	Land & Building	2,20,000
Reserves for taxation	20,000	Goodwill	35,000
P & L Account	20,000	Preliminary exp.	10,000
	5,67,000		**5,67,000**

During the year provision for taxation was ₹ 20,000. Dividend was proposed at ₹ 10,000. Profit carried from the last year was 15,000. You are required to calculate.

(*i*) Current ratio

(*ii*) Liquidity ratio

(*iii*) Debt-equity ratio

(*iv*) Fixed assets ratio and

(*v*) Fixed charges cover ratio

[**Ans.** (1) 1.26, (2) 0.96, (3) 0.17, (4) 0.83, (5) 8.95
(Profit before interest and tax ₹ 39400,
Fixed charges 2,800 + 1,600 = 44000)]

16. From the following given ratios and figures, prepare a summarized Balance Sheet of XYZ Co. Ltd., for the year ended 31.12.2005.

(*a*) Working capital = ₹ 60,000

(*b*) Reserves and surplus = ₹ 40,000

(*c*) Bank overdraft = ₹ 10,000

(*d*) Assets (fixed) proprietorship ratio = 0.75

(*e*) Current ratio = 2.50

(*f*) Liquid ratio = 1.50

[**Ans.** Assets – Total: ₹ 2,80,000: Fixed assets: ₹ 1,80,000: Stock: ₹ 40,000; Other current assets: ₹ 60,000; Liabilities – Total : ₹ 2,80,000; Capital: ₹ 2,00,000; Reserves and surplus: ₹ 40,000; Bank overdraft: ₹ 10,000; Other current liabilities: ₹ 30,000]

17. From the following details prepare statement of Proprietary funds with as many details as possible.

(*i*) Stock velocity = 6

(*ii*) Capital turnover ratio = 2

(*iii*) Fixed assets turnover ratio = 4

(*iv*) Gross profit turnover ratio = 20 percent

(*v*) Debtors velocity = 2 months

(*vi*) Creditors velocity = 73 days

The Gross profit was ₹ 60,000. Reserves and surplus amount to ₹ 20,000. Closing stock was ₹ 5,000 in excess of opening stock

[**Ans.** Proprietary funds: ₹ 1,20,000; Capital : ₹ 1,00,000; Reserves : ₹ 20,000; Current liabilities : ₹ 49,000; Debtors ₹ 50,000; Closing stock : ₹ 42,500; Other current assets: ₹ 16,500; (Bal. fig. in Balance Sheet) fixed assets ₹ 60,000]

18. From the following comparative Balance Sheet of Shahnaz Shahab Limited for the years 2010 and 2011, find out the change (Increase/Decrease) in the absolute figures and also the changes in percentage.

Particulars	*2010 (₹)*	*2011 (₹)*
I. **EQUITY AND LIABILITIES**		
1. **Shareholders Funds:**		
(*a*) Share Capital	16,20,000	18,00,000
2. **Non-current Liabilities**		
(*a*) Long-term borrowings	3,60,000	4,95,000
3. **Current Liabilities**	1,35,000	1,35,000
	21,15,000	24,30,000
II. **ASSETS**		
1. **Non-current Assets**		
(*a*) *Fixed Assets*		
(*i*) *Tangible assets*	10,80,000	13,50,000
(*ii*) *Intangible assets*	4,50,000	6,30,000
(*iii*) Capital work-in-progress	3,60,000	2,70,000
2. **Current Assets**	2,25,000	1,80,000
	1,50,00,000	1,54,50,000

19. From the following information prepare a Comparative Income Statement:

Particulars	*2012 (₹)*	*2013 (₹)*
Revenue from operations	6,40,000	8,00,000
Cost of goods sold	3,20,000	4,80,000
Administrative, selling & distribution expenses	64,000	1,60,000
Other income	32,000	48,000
Income tax	96,000	1,12,000

20. Prepare the comparative Balance Sheet of M/s Balaji Traders from the following:

Particulars	*2010 (₹)*	*2011 (₹)*
I. **EQUITY AND LIABILITIES**		
1. **Shareholders Funds:**		
(*a*) Share Capital	32,000	56,000

Notes

(b) Reserves and Surplus	9,600	8,000
2. **Non-current Liabilities:**		
(a) Long-term borrowings	40,000	40,000
	81,600	1,04,000
II. **ASSETS**		
1. **Non-current Assets**		
(a) *Fixed Assets*		
(i) *Tangible assets*	64,000	81,600
2. **Current Assets**		
(a) Trade receivables	8,000	16,000
(b) Cash and cash equivalents	9,600	6,400
	81,600	1,04,000

21. Following are the Balance Sheet of Radha Ltd., as on 31.12.2008 and 31.12.2009.

Particulars	*2008 (₹)*	*2009 (₹)*
I. **EQUITY AND LIABILITIES**		
1. **Shareholders Funds:**		
(a) Share Capital	13,00,000	19,50,000
(b) Reserves and Surplus	13,00,000	13,00,000
2. **Non-current Liabilities:**		
Long-term borrowings	2,60,000	10,40,000
3. **Current Liabilities:**	3,90,000	6,50,000
	32,50,000	49,40,000
II. **ASSETS**		
1. **Non-current Assets**		
(a) *Fixed Assets*		
(i) *Tangible assets*	26,00,000	39,00,000
2. **Current Assets**	6,50,000	10,40,000
	32,50,000	49,40,000

You are required to prepare a comparative Balance Sheet on the basis of the information given in the above Balance Sheet.

22. Prepare a Comparative Balance Sheet of M/s Gupta Traders from the following information:

Particulars	*2011 (₹)*	*2012 (₹)*	*Particulars*	*2011 ₹*	*2012 ₹*
Share Capital	35,000	50,000	Tangible assets	55,000	66,000
Reserve and surplus	6,000	5,000	Trade receivable	5,000	10,000

Long-term borrowings	25,000	25,000	Cash and cash equivalent	6,000	4,000
	66,000	80,000		66,000	80,000

23. Prepare a Common Size Balance Sheet from the following information:

Particulars	*2012* (₹)	*2013* (₹)
Equity share capital	7,20,000	9,00,000
Preference share capital	4,80,000	5,40,000
Reserves and Surplus	1,50,000	1,20,000
Long-term borrowing	2,40,000	1,80,000
Short-term borrowing	1,20,000	1,20,000
Trade Payable	48,000	60,000
Short term provision	18,000	24,000
Tangible assets	9,60,000	14,40,000
Intangible assets	6,00,000	3,60,000
Current assets	2,16,000	1,44,000

24. From the following information prepare common size income statement.

Particulars	*March 31, 2012*	*March 31, 2011*
Revenue from operations	10,00,000	12,50,000
Cost of materials consumed	7,70,000	11,00,000
Other income	1,00,000	1,25,000
Finance cost	1,65,000	1,50,000
Other expenses	1,10,000	75,000
Profit	55,000	50,000

25. From the following information relating to B C Ltd., prepare a comparative Income Statement, showing the percentage increase/decrease in 2011 over 2010:

Particulars	*2010* (₹)	*2011* (₹)
Revenue from operations	2,00,000	4,00,000
Cost of materials consumed	80,000	1,44,000
Other expenses	60,000	1,32,000
Income tax	10,000	19,000
Profit	50,000	1,05,000

26. From the following Balance Sheet of Usha Chemical Ltd., on 31st December, 2011 and 2012, prepare comparative balance sheets.

Particulars	*2011 (₹)*	*2012 (₹)*
I. EQUITY AND LIABILITIES		
1. Shareholders Funds:		

Notes

	(a) Share Capital	5,00,000	10,00,000
	(b) Reserves and Surplus	3,00,000	2,00,000
2.	**Non-current Liabilities:**		
	(a) Long-term borrowings	5,00,000	8,00,000
3.	**Current Liabilities:**		
	(a) Trade Payables	2,00,000	4,00,000
		15,00,000	24,00,000
II.	**ASSETS**		
1.	**Non-current Assets**		
	(a) *Fixed Assets*		
	(i) *Tangible assets*	10,00,000	15,00,000
2.	**Current Assets**		
	(a) Cash and cash equivalents	5,00,000	9,00,000
		15,00,000	24,00,000

27. From the following information, prepare a comparative income statement.

Particulars	*2012* ₹	*2013* ₹
Revenue from operations	10,00,000	15,00,000
Cost of materials consumed	8,00,000	11,00,000
Purchase of stock-in-trade	1,00,000	1,50,000
Other expenses	1,00,000	2,50,000
Other Income	20,000	24,000
Income tax	40,000	80,000

28. From the following summarised Balance Sheet as 31st December, prepare a Comparative Balance Sheet of X Ltd. as at that date.

	Particulars	*2011 (₹)*	*2012 (₹)*
I.	**EQUITY AND LIABILITIES**		
1.	**Shareholders Funds:**		
	(a) Share Capital		
	(i) Equity Share Capital	60,00,000	60,00,000
	(ii) Preference Share Capital	15,00,000	15,00,000
	(b) Reserve and Surplus	15,00,000	18,00,000
2.	**Non-current Liabilities:**		
	(a) Long-term borrowings	30,00,000	27,00,000
3.	**Current Liabilities:**		
	(a) Short-term borrowings	15,00,000	18,00,000
	(b) Other current liabilities	12,00,000	13,20,000

(*c*) Short-term provisions	3,00,000	3,30,000
	1,50,00,000	1,54,50,000
II. ASSETS		
1. Non-current Assets		
(*a*) *Fixed Assets*		
(*i*) *Tangible assets*	90,00,000	1,08,00,000
(*ii*) Intangible assets	15,00,000	15,00,000
2. Current Assets		
(*a*) Cash and cash equivalents	45,00,000	31,50,000
	1,50,00,000	1,54,50,000

Notes

29. What is meant by Ratio Analysis?
30. List out the Liquidity Ratios.
31. What are Turnover Ratios?
32. What do you understand by Operating Ratios and Stock Turnover Ratio?
33. Briefly explain the objectives of Ratio Analysis.
34. What are the Limitations Ratio Analysis.
35. Discuss some of the important ratios usually worked from the financial statement showing how they would be useful to top level management.
36. "Ratio analysis is a tool to examine the health of a business with a view to make the financial results more intelligible".
37. Discuss the significance of various accounting ratios in the analysis of financial statements.

Unit–5

Fund Flow Statement

Notes

Structure

5.1. Definition of Working Capital

Capital of the concern may be divided into two major heading

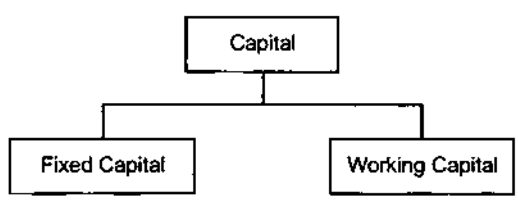

Fig. 5.1. Capital of the Business

Fixed capital means that capital, which is used for long-term investment of the business concern. For example, purchase of permanent assets. Normally it consists of non-recurring in nature.

Working Capital is another part of the capital which is needed for meeting day to day requirement of the business concern. For example, payment to creditors, salary paid to workers, purchase of raw materials etc., normally it consists of recurring in nature. It can be easily converted into cash. Hence, it is also known as short-term capital.

There are some definitions given by experts, such as:

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According to the definition of **Mead, Baker and Malott**, *"Working Capital means Current Assets"*. According to the definition of **J.S. Mill**, *"The sum of the current asset is the working capital of a business"*. —

According to the definition of **Weston and Brigham**, *"Working Capital refers to a firm's investment in short-term assets, cash, short-term securities, accounts receivables and inventories"*.

Notes

According to the definition of **Bonneville**, *"Any acquisition of funds which increases the current assets, increase working capital also for they are one and the same"*. According to the definition of Shubin, *"Working Capital is the amount of funds necessary to cover the cost of operating the enterprises"*.

According to the definition of **Genestenberg**, *"Circulating capital means current assets of a company that are changed in the ordinary course of business from one form to another, for example, from cash to inventories, inventories to receivables, receivables to cash"*.

5.2. Nature and Scope of Working Capital

Working capital can be classified or understood with the help of the following two important concepts.

5.3. Learning Objectives

After going through this unit you should be able to:

- explain nature, scope and definition of working capital.
- illustrate working capital cycle.
- assess and compute the working capital management.
- describe profitability through liquidity trade-off and working capital policy.
- state overview of working capital management.

5.4. Introduction to Working Capital

Working capital management is also one of the important parts of the financial management. It is concerned with short-term finance of the business concern which is closely related trade between profitability and liquidity. Efficient working capital management leads to improve the operating performance of the business concern and it helps to meet the short term liquidity. Hence, study of working capital management is not only an important part of financial management but also are overall management of the business concern.

Working capital is described as the capital which is not fixed but the more common uses of the working capital is to consider it as the difference between the book value of current assets an current liabilities. This unit deals with the following important aspects of the working capital management:

- Meaning of Working Capital
- Concept of Working Capital
- Types of Working Capital
- Needs of Working Capital

Notes

- Factors determining Working Capital
- Computation of Working Capital
- Sources of Working Capital
- Working Capital Management Policy
- Working Capital and Banking Committee

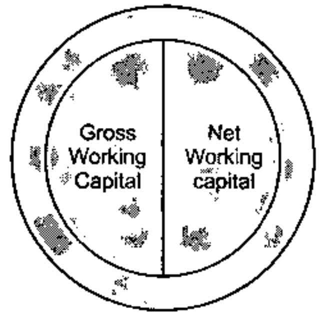


Fig. 5.2. Working Capital Concept

Gross Working Capital

Gross Working Capital is the general concept which determines the working capital concept. Thus, the gross working capital is the capital invested in total current assets of the business concern.

$$\boxed{GWC = CA}$$

Net Working Capital

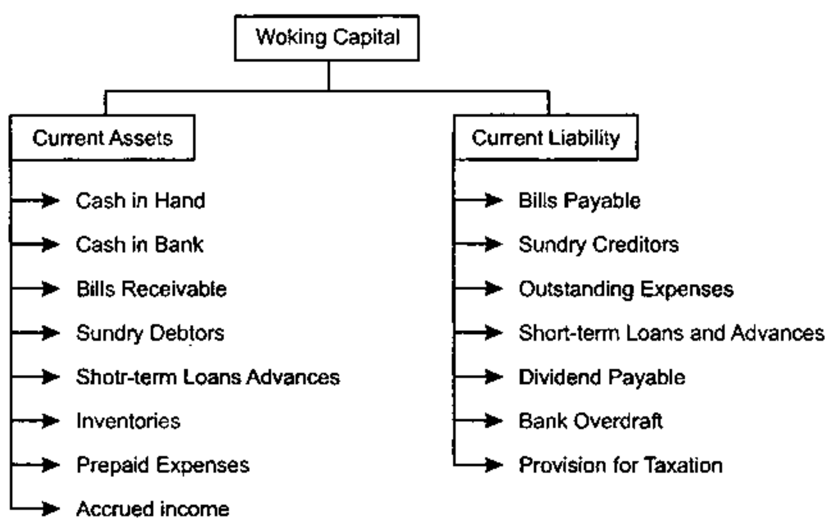
Net Working Capital is the specific concept, which, considers both current assets and current liability of the concern. Net Working Capital is the excess of current assets over the current liability of the concern during a particular period.

If the current assets exceed the current liabilities it is said to be positive working capital; it is reverse, it is said to be Negative working capital.

$$\boxed{NWC = CA - CL}$$

Component of Working Capital

Working capital constitutes various current assets and current liabilities. This can be illustrated by the following chart.



5.5. Types of Working Capital

Working Capital may be classified into three important types on the basis of time.

Notes

Permanent Working Capital

It is also known as Fixed Working Capital. It is the capital; the business concern must maintain certain amount of capital at minimum level at all times. The level of Permanent Capital depends upon the nature of the business. Permanent or Fixed Working Capital will not change irrespective of time or volume of sales.

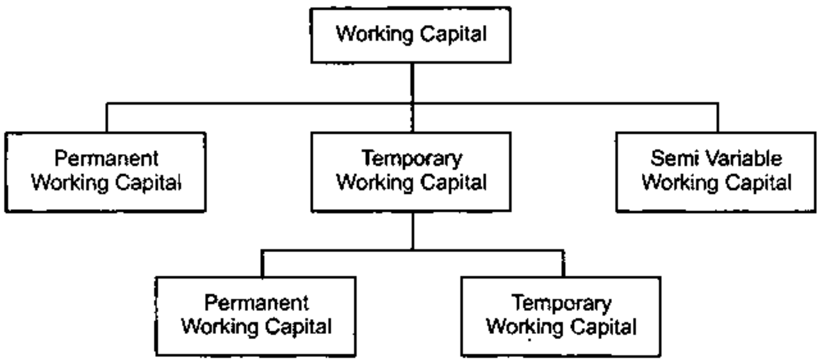


Fig. 5.3. Types of Working Capital

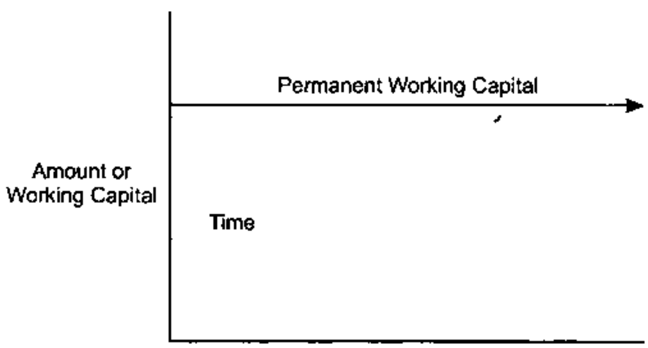


Fig. 5.4. Permanent Working Capital.

Temporary Working Capital

It is also known as variable working capital. It is the amount of capital which is required to meet the Seasonal demands and some special purposes. It can be further classified into Seasonal Working Capital and Special Working Capital.

The capital required to meet the seasonal needs of the business concern is called as Seasonal Working Capital. The capital required to meet the special exigencies such as launching of extensive marketing campaigns for conducting research, etc.

Semi Variable Working Capital

Certain amount of Working Capital is in the field level up to a certain stage and after that it will increase depending upon the change of sales or time.

Notes

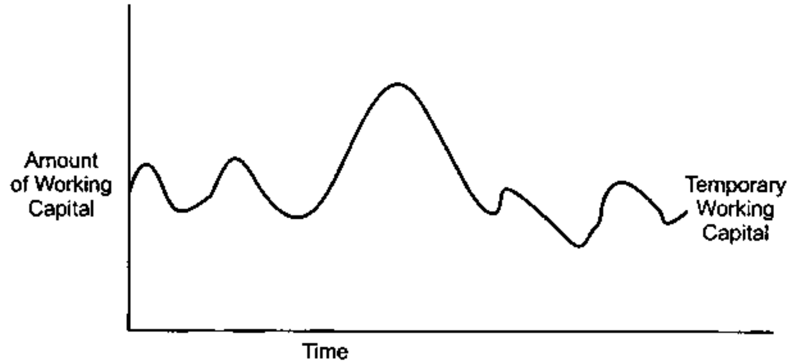


Fig. 5.5. Temporary Working Capital

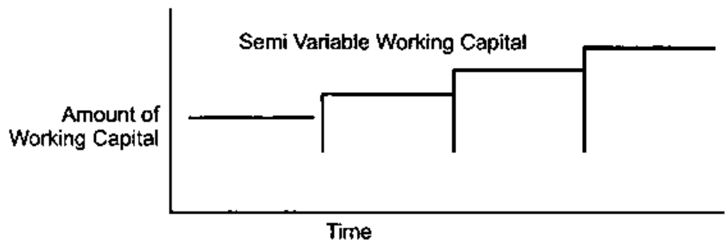


Fig. 5.6. Semi Variable Working Capital

5.6. Needs of Working Capital

Working Capital is an essential part of the business concern. Every business concern must maintain certain amount of Working Capital for their day-to-day requirements and meet the short-term obligations. Working Capital is needed for the following purposes.

1. **Purchase of raw materials and spares:** The basic part of manufacturing process is, raw materials. It should purchase frequently according to the needs of the business concern. Hence, every business concern maintains certain amount as Working Capital to purchase raw materials, components, spares, etc.
2. **Payment of wages and salary:** The next part of Working Capital is payment of wages and salaries to labour and employees. Periodical payment facilities make employees perfect in their work. So a business concern maintains adequate the amount of working capital to make the payment of wages and salaries.
3. **Day-to-day expenses:** A business concern has to meet various expenditures regarding the operations at daily basis like fuel, power, office expenses, etc.
4. **Provide credit obligations:** A business concern responsible to provide credit facilities to the customer and meet the short-term obligation. So the concern must provide adequate Working Capital.

Working Capital Position/Balanced Working Capital Position

A business concern must maintain a sound Working Capital position to improve the efficiency of business operation and efficient management of finance. Both excessive and inadequate Working Capital lead to some problems in the business concern.

Notes

A.Causes and effects of excessive working capital

- Excessive Working Capital leads to unnecessary accumulation of raw materials, components and spares.
- Excessive Working Capital results in locking up of excess Working Capital.
- It creates bad debts, reduces collection periods, etc.
- It leads to reduce the profits.

B. Causes and effects of inadequate working capital

- Inadequate working capital cannot buy its requirements in bulk order.
- It becomes difficult to implement operating plans and activate the firm's profit target.
- It becomes impossible to utilize efficiently the fixed assets.
- The rate of return on investment also falls with the shortage of Working Capital.
- It reduces the overall operation of the business.

5.7. Computation (OR Estimation) of Working Capital: Working Capital Cycle

Working Capital requirement depends upon number of factors. Now the discussion is on how to calculate the Working Capital needs of the business concern. It may also depend upon various factors but some of the common methods are used to estimate the Working Capital.

A. Estimation of Components of Working Capital Method

Working capital consists of various current assets and current liabilities. Hence, we have to estimate how much current assets as inventories required and how much cash required to meet the short term obligations. Finance Manager first estimates the assets and required Working Capital for a particular period.

B. Percent of Sales Method

Based on the past experience between Sales and Working Capital requirements, a ratio can be determined for estimating the Working Capital requirement in future. It is the simple and tradition method to estimate the Working Capital requirements. Under this method, first we have to find out the sales to Working Capital ratio and based on that we have to estimate Working Capital requirements. This method also expresses the relationship between the Sales and Working Capital.

C. Operating Cycle

Working Capital requirements depend upon the operating cycle of the business. The operating cycle begins with the acquisition of raw material and ends with the collection of receivables. Operating cycle consists of the following important stages:

1. Raw Material and Storage Stage, (R)
2. Work in Process Stage, (W)
3. Finished Goods Stage, (F)

4. Debtors Collection Stage, (D)
5. Creditors Payment Period Stage, (C)

$$O = R + W + F + D - C$$

Notes

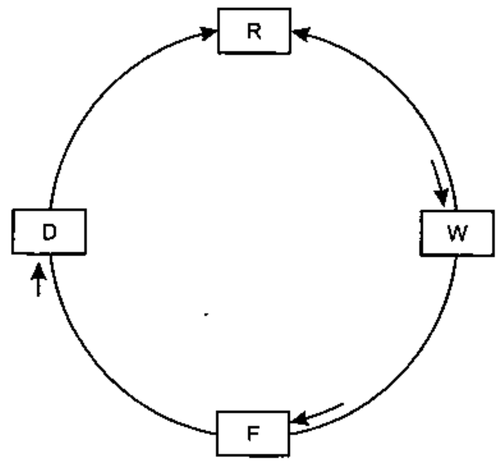


Fig. 5.7. Working Capital Cycle

Each component of the operating cycle can be calculated by the following formula:

$$R = \frac{\text{Average Stock of Raw Material}}{\text{Average Raw Material Consumption Per Day}}$$

$$W = \frac{\text{Average Work in Process Inventory}}{\text{Average Cost of Production Per Day}}$$

$$F = \frac{\text{Average Finished Stock Inventory}}{\text{Average cost of Goods Sold Per Day}}$$

$$D = \frac{\text{Average Book Debts}}{\text{Average Credit Sales Per Day}}$$

$$C = \frac{\text{Average Trade Creditors}}{\text{Average Credit Purchase Per Day}}$$

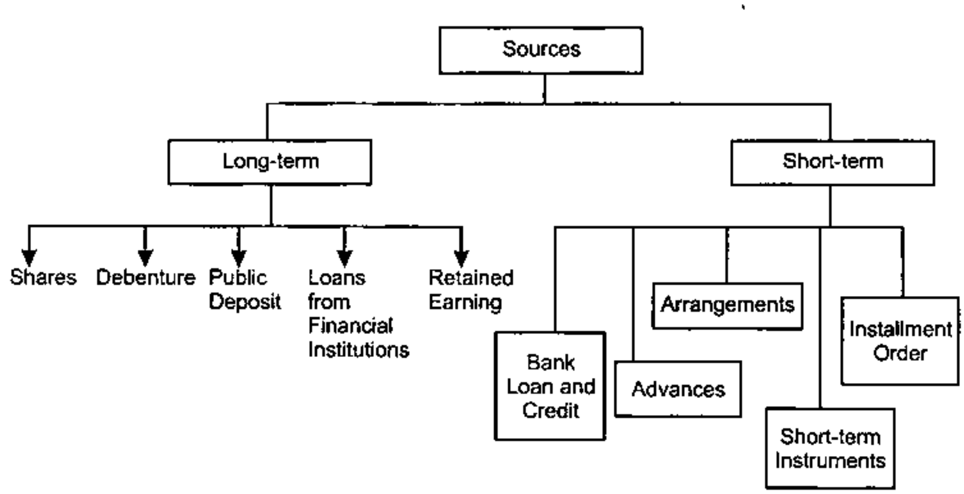


Fig. 5.8. ?????

The above sources are also classified into internal sources and external sources of working capital. Internal sources such as:

- Retained Earnings
- Depreciation Funds etc.

External sources such as:

- Debentures and Public Deposits
- Loans from Banks and Financial Institutions
- Advances and Credit
- Financial arrangements like Factoring, etc.

5.8. Introduction

The traditional concept of profit and loss account and balance sheet has a limited role to play in financial analysis. The profit and loss account reflects the results of the business operations for a specified period of time. It takes into account only the expenses incurred and income received during the accounting period. The balance sheet gives a summary of the assets and liabilities at a particular period of time. And at the same time, balance sheet does not explain the details about the movement of funds. In actual practice, a business concern receives funds from various sources and invested in various ways of investment. It is a continuous process. The ultimate aim of the financial management is to study and control these funds in order to maintain the solvency and financial soundness of the firm. For the purpose of complete study of sources and applications of funds over the accounting period, a separate statement is essential to find the periodical increase or decrease of such funds of an enterprise. This statement is called fund flow statement.

5.9. Meaning of Fund Flow Statement

The fund flow statement is a statement which reveals the methods by which the business has been financed and how it has used its funds between two balance sheet dates.

In the words of Foulke : "A statement of sources and application of funds is a technical device, designed to analyse the changes in the financial conditions of a business enterprise between two balance sheet dates."

5.10. Different Names of Fund Flow Statement

A statement of sources and application of funds

A statement of sources and uses of funds

Where Got and where Gone statement

Inflow-outflow of fund statement

Statement of funds supplied and applied; funds received and disbursed statement

5.11. Managerial Uses of Fund Flow Statement

Fund flow statement is an invaluable analytical tool for a financial manager for the purpose of evaluating the employment of funds by a firm and also to assess sources of such funds. Following are the important managerial uses of fund flow statement.

Notes

1. The foremost use of the fund flow statement is to explain the reasons for changes in the assets and liabilities between two balance sheet dates.
2. Fund flow statement gives details about the funds obtained and used in past. Based upon this detail, manager can take correct actions at appropriate times.
3. Fund flow statement acts as a control device when compared with budgeted figures. It also gives guidance to the finance manager for taking remedial action if there is any deviation.
4. It helps the management to formulate various financial policies—viz dividend, bonus etc.
5. It gives guidance to the management with regard to working capital. Through fund flow statement, management can take proper steps for effective utilisation of surplus working capital or in case of inadequacy, suitable arrangement can be made for improving the working capital position.
6. It identifies the strong and weak financial areas of the firm.
7. It gives the answers for various financial intricate questions :
   – How much funds were generated ?
   – How were the funds used ?
8. Effective utilisation of available resources and scarce resources should be allocated according to the preferential needs.
9. With the help of the fund flow statement, financial and lending institutions can easily evaluate the credit worthiness and repaying capacity of the borrowing company.
10. It enables the management to reformulate the firm's financial activity on the basis of the statement.

5.12. Limitations of Fund Flow Statement

1. In the real sense, the fund flow statement lacks originality, because it is only a rearrangement of data given in financial statements.
2. It indicates only the past year's performance and is not for the future. Even to prepare projected fund flow statement, it cannot show much accuracy.
3. It cannot reveal continuous changes. Because, only any particular two years are taken into account for analysis purpose.
4. Fund flow statement is not a substitute for a financial statement. It gives only some informations about changes in working capital alone.

5.13. Steps in Preparation of Fund Flow Statement

(*i*) Preparation of fund flow statement.

(*ii*) Preparation of statement of changes in working capital.

(*iii*) Preparation of adjusted profits and loss account (to find out fund from operation or fund lost in operation).

(*iv*) Adjustment and their treatments.

(*v*) Preparation of separate ledger.

(*vi*) Treatment about the provision for taxation and proposed divider.

Notes

NOTE: Fund flow statement alone is a major part of the solution: remaining other things *i.e.,* working capital statement, P.L. A /c, preparation of ledger, treatment of provision for taxation and proposed dividend, adjustment etc were supported to work the fund flow statement.

I. Preparation Fund Flow Statement

Here we have to prepare the fund flow statement in the T Shape

I. Fund Flow Statement : (Specimen form)

Source of Funds	Amount ₹	Applications of Funds	Amount ₹
Issue of shares	XX	Redemption of redeemable	XX
Issue of debentures	XX	Preference shares	XX
Loan borrowed	XX	Redemption of debentures	XX
(Long term, medium term)		Repayment of loans	XX
Acceptance of deposits	XX	Repayment of deposits	XX
Sale of fixed assets	XX	Purchase of fixed assets	XX
Sale of investments (Long term)	XX	Purchase of long term investments	XX
Decrease in working capital	XX	Payment of dividend	XX
(Transfer from working capital statements)		Income tax paid	XX
Fund from operation	XX	Increase in working capital	XX
(Transfer from P&L A/c		Fund loss in operation	XX
Working capital statement)		(Transfer from P&L A/c)	

II. Working Capital Statement

For the purpose of finding out increase or decrease in working capital, we have to prepare statement of changes in working capital. [TCA − TCL = WC]

Particulars	**Year I**	**Year II**
Current Assets		
Cash in hand	XX	XX
Cash at bank	XX	XX
Sundry debtors	XX	XX
Bills receivable	XX	XX
Marketable securities	XX	XX
Inventory	XX	XX
Prepaid expenses	XX	XX

Notes

Short term investment	XX	XX
Accrued incomes	XX	XX
Total Current Assets (TCA) (A)	XX	XX
Current Liabilities		
Sundry Creditors	XX	XX
Bills payable	XX	XX
Outstanding expenses	XX	XX
Bank overdraft	XX	XX
Income received in advance	XX	XX
Short term loans	XX	XX
Cash credit from bank	XX	XX
Provision for taxation	XX	XX
Proposed dividend	XX	XX
Provision against current assets	XX	XX
Provision for doubtful debts	XX	XX
Total Current Liabilities (TCL) (B)	XX	XX
Working Capital (A-B)	XX	XX
Increase of Decrease	XX	

[TAC – TCL = WC]

After the computation of working capital, we have to find out the increase or decrease in working.

III. Fund from Operation : Fund from operation is found out by two methods

(*i*) Statement method.

(*ii*) Accounting method.

Normally, accounting method is easy and convenient. So, we have to adopt accounting method *i.e.*, profit and loss account is used to find out the fund from operation. Here, profit and loss account is prepared in a usual procedure.

Particulars	Amount ₹	Particulars	Amount ₹
To Goodwill written off	XX	By Balance b/d	XX
To Preliminary expenses written off	XX	By Profit on sale of fixed assets	XX
To Patents written off	XX		
To Depreciation	XX	By Interest sale of investment	XX
To Dividend paid	XX	By Any other non-operating incomes	XX
To Provision for taxation	XX		XX
To Loss on sale of fixed assets	XX	By Fund from operation	XX
To Discount on issue of shares	XX		

To Interim dividend paid	XX		
To Balance c/d	XX		
To Fund operation	XX		
To Fund operation	XX		XX

Notes

IV. Important adjustments and their treatments

All the adjustments appear in two places :

Adjustment		Treatment
1. Depreciation	–	P.L. A/c debit side
		Respective asset A/c credit side
2. Dividend paid	–	P.L. A/c debit side
		Fund flow statement Application side
3. Income tax paid	–	Income tax A/c debit side
		Fund flow statement—Application side
4. Income tax provision	–	P.L. A/c debit side
		Income tax A/c credit side
5. Loss on sale of fixed	–	P.L. A/c debit side
		Assets Respective asset A/c credit side
6. Interim dividend paid	–	P.L . A/c debit side
		Fund flow statement—Application side

V. Preparation of separate ledger A/c, if necessary *i.e.,* about the non-current (either Assets or Liability) items related information given in the adjustment means we have to prepare separate ledger. Balances from this ledger can be transferred to fund flow statement means we have to prepare a separate ledger. Balances from this ledger can be transferred to fund flow statement.

VI. Treatment about the provision for taxation and proposed dividend

Provision for taxation and proposed dividend taken as current liability means it should appear under working capital statement.

Some times, regarding the provision for taxation, information is given in the adjustment. So, it should be treated as non current liability. Provision for taxation taken as non-current liability means proposed dividend is also taken as a non-current liability.

(*a*) Treatment of provision for taxation

(*i*) Income Tax provided given in the adjustment, we have to find the tax paid-P.L. A/c debit side

Income Tax A/c credit

(Balancing figure of taxation A/c is called tax paid and then it is transferred to Applications side)

(*ii*) Income tax paid given in the adjustment, we have to find the income tax provision.

Fund flow statement – application side

Income tax A/c – debit side

(Balancing figure of taxation A/c is called tax provided and then it is transferred to P.L. A/c debit side)

Notes

(*b*) **Treatment of proposed dividend**

Whenever provision for taxation is treated as non-current liability, proposed dividend is also taken as non-current liability. At that time, the following rules will be applicable.

Last year amount – application side

Current year amount : profit & loss A/c debit side.

Illustrations and Solutions

Illustration 1. The following are the summarised balance sheets of M/s. Krishna Ltd. as on 31.12.2019 and 2020

Liabilities	2019 Rs.	2020 Rs.
10% preference shares	1,00,000	1,10,000
Equity Shares	2,20,000	2,50,000
Share premium	20,000	26,000
Profit & Loss A/c	1,04,000	1,34,000
12% debentures	70,00	64,000
Creditors	38,000	46,000
Bills Payable	5,000	4,000
Provision for tax	10,000	12,000
Dividend Payable	7,000	8,000
	5,74,000	6,54,000

Assets	2019 Rs.	2020 Rs.
Machinery	2,00,000	2,30,000
Buildings	1,50,000	1,76,000
Land	18,000	18,000
Cash	42,000	32,000
Debtors	38,000	38,000
Bills receivable	42,000	62,000
Stock	84,000	98,000
	5,74,000	6,54,000

You are required to prepare a statement of sources and application of funds

Solution : **Fund Flow Statement**

Notes

Particulars	Amount ₹	Particulars	Amount ₹
Issue of preference shares	10,000	Purchase of machinery	30,000
Issue of Equity shares	30,000	Purchase of Building	26,000
Share premium received	6,000	Increase in working capital	14,000
Fund from operation	30,000	Redemption of debenture	6,000
	76,000		76,000

Working : **(*i*) Statement of changes in working capital**

	2019 ₹	2020 ₹
Current Assets:		
Cash	42,000	32,000
Debtors	38,000	38,000
Bills receivables	42,000	62,000
Stock	84,000	98,000
Total current assets	2,06,000	2,30,000
Current Liabilities :		
Creditors	38,000	46,000
Bills payable	5,000	4,000
Provision for Tax	10,000	12,000
Dividend payable	7,000	8,000
Total current liabilities	60,000	70,000
Working capital	1,46,000	1,60,000

Increase in working capital : ₹ 14000 (1,46,000 – 1,60,000)

[Transfer to Fund Flow Statement]

(*ii*) Profit and Loss Account

To Balance b/d (Closing)	1,34,000	By Balance c/d (Opening)	1,04,000
		By Fund from operation	30,000
	1,34,000		1,34,000

Illustration 2. *From the following balance sheets, prepare schedule of changes in working capital.*

Liabilities	Dec. 1980 ₹	Dec. 1981 ₹	Assets	Dec. 1980 ₹	Dec. 1981 ₹
Share capital	2,00,000	2,50,000	Cash	30,000	47,000
Creditors	70,000	45,000	Debtors	1,20,000	1,15,000
Retained			Land	50,000	66,000

Earnings	10,000	23,000	Stock	80,000	90,000
	2,80,000	3,18,000		2,80,000	3,18,000

Notes

Solution : Fund Flow Statement

Particulars	Amount ₹	Particulars	Amount ₹
Issue of shares	50,000	Purchase of Land	16,000
Fund from operation	13,000	Increase in working capital	47,000
	63,000		63,000

Working : (*i*) Statement of changes in working capital

	1980 ₹	1981 ₹
Current Assets:		
Cash	30,000	47,000
Debtors	1,20,000	1,15,000
Stock	80,000	90,000
Total current assets	2,30,000	2,52,000
Current Liabilities :		
Creditors	70,000	45,000
Total current Liabilities	70,000	45,000
Working capital	1,60,000	2,07,000

Increase in working capital : (1,60,000 – 2,07,000)

(*ii*) Profit and Loss Account

To Balance b/d	23,000	By Balance c/d	10,000
		By Fund from operation (B/f)	13,000
	23,000		23,000

Illustration 3. *The following are the summarised balance sheets of X Ltd., as on 31 December 2018 and 2019.*

Liabilities	*31st Dec. 2018* ₹	*31st Dec. 2019* ₹	*Assets*	*31st Dec. 2018* ₹	*31st Dec. 2019* ₹
Redeemable Preference Shares		*10,000*	*Fixed Assets*	*41,000*	*40,000*
Equity shares	*40,000*	*40,000*	*Less : Depreciation*	*11,000*	*15,000*
General Reserve	*2,000*	*2,000*			
Profit & loss A/c	*1,000*	*1,200*		*30,000*	*25,000*
Debentures	*6,000*	*7,000*	*Debtors*	*20,000*	*24,000*

Creditors	*12,000*	*11,000*	*Stock*	*30,000*	*35,000*
Provision for Tax	*3,000*	*4,200*	*Prepaid exp.*	*300*	*500*
Proposed dividend	*5,000*	*5,800*	*Cash*	*1,200*	*3,500*
Bank overdraft	*12,500*	*6,800*			
	81,500	*88,000*		*81,500*	*88,000*

Notes

You are required to prepare :

1. *A statement showing changes in the working capital*
2. *A statement of sources and application of funds.*

Solution : Fund Flow Statement

Source of funds	₹	Application of funds	₹
Issue of preference shares	10,000	Increase in working capital	16,200
Issue of Debentures	1,000		
Sale of fixed assets	1,000		
Fund from operation	4,200		
	16,200		16,200

Working : (*i*) Statement of changes in working capital

	2018 ₹	2019 ₹
Current Assets:		
Debtors	20,000	24,000
Stock	30,000	35,000
Prepaid Expenses	300	500
Cash	1,200	3,500
Total Current Assets	51,500	63,000
Current Liabilities :		
Creditors	12,000	11,000
Provision for tax	3,000	4,200
Proposed Dividend	5,000	5,800
Bank Overdraft	12,500	6,800
Total current liabilities	32,500	27,800
Working capital	19,000	35,200
Increase in working capital	16,200	(19,000 – 35,200)

Hint : Provision for taxation and proposed dividend taken as current liabilities.

(*ii*) Profit and Loss Account

To Balance b/d	1,200	By Balance c/d	1,000
To Depreciation	4,000	By Fund from operation	4,200
	5,200		5,200

Illustration 4. From the following balance sheets, prepare a statement showing changes in working capital during 1995.

Balance sheet of Pioneer Ltd. as on 31st December.

Notes

Liabilities	*1994 (₹)*	*1995 (₹)*
Share capital	*5,00,000*	*6,00,000*
Reserves	*1,50,000*	*1,80,000*
P.L. A/c	*40,000*	*65,000*
Debentures	*3,00,000*	*2,50,000*
Creditors for goods	*1,70,000*	*1,60,000*
Provision for income tax	*60,000*	*80,000*
	12,20,000	*13,35,000*
Assets	***2018 (₹)***	***2019 (₹)***
Fixed assets	*10,00,000*	*11,20,000*
Less : Depreciation	*3,70,000*	*4,60,000*
	6,30,000	*6,60,000*
Stock	*2,40,000*	*3,70,000*
Book debts	*2,50,000*	*2,30,000*
Cash in hand and at Bank Balance	*80,000*	*60,000*
Preliminary Expenses	*20,000*	*15,000*
	12,20,000	*13,35,000*

Solution : Fund Flow Statement

Source of funds	₹	Application of funds	₹
Issue of shares	1,00,000	Redemption of debentures	50,000
Fund from operation	1,50,000	Purchase of fixed assets	1,20,000
		Increase in working capital	80,000
	2,50,000		2,50,000

Working : (*i*) Statement of changes in working capital

	1994 ₹	1995 ₹
Current Assets:		
Stock	2,40,000	3,70,000
Book Debts	2,40,000	3,70,000
Cash in hand & Bank Balance	80,000	60,000
Total Current Assets	5,70,000	60,000
Current Liabilities :		

Creditors for goods	1,70,000	1,60,000
Provision for income tax	60,000	80,000
Total current liabilities	2,30,000	2,40,000
Working capital	3,40,000	4,20,000
Increase in working capital	80,000	3,40,000 – 4,20,000

Notes

Hint : Provision for taxation and proposed dividend taken as current liabilities.

(*ii*) Profit and Loss Account

	₹		₹
To Balance b/d	65,000	By Balance c/d	40,000
To Reserves	30,000	By Fund from operation	1,50,000
To Preliminary expenses written off	5,000		
To Depreciation	90,000		
	1,90,000		1,90,000

Illustration 5. Calculate fund from operation from the information given below as on 31.3.2000.

1. Net profit for the year ended 31.3.2000 ₹ 6,50,000.
2. Gain on sale of buildings ₹ 35,500.
3. Goodwill appears in the books at ₹ 1,80,000 out of that 10% has been written off during the year.
4. Old machinery worth ₹ 8,000 has been sold for ₹ 6,500 during the year.
5. ₹ 1,25,000 have been transferred to reserve fund.
6. Depreciation has been provided during the year on machinery and furniture at 20% whose value is ₹ 6,50,000.

Solution: Calculation of Fund from Operation

	₹	₹
Net profit for the year ended 31.3.2019		6,50,000
Add : Non fund items : [P.L. A/c Debit side items]		
Goodwill written off	18,000	
(1,80,000 × 10/100)		
Loss on sale of machinery		
(8000 – 6500)	1,500	
Transferred to Reserve fund	1,25,000	
Depreciation		
(6,50,000 × 20/100)	1,30,000	
		2,74,500
		9,24,500

Less : Non fund items [P.L A/c credit side items]	
Gain on sale of Buildings	35,500
Fund from operation	8,89,000

Notes

Illustration 6. *From the following balance sheets of a sole trader, prepare a fund flow statement.*

Liabilities	*1999* ₹	*2000* ₹	*Assets*	*1999* ₹	*2000* ₹
Capital	*63,000*	*1,00,000*	*Cash*	*15,000*	*20,000*
Long term loans	*50,000*	*60,000*	*Debtors*	*30,000*	*28,000*
Trade creditors	*42,000*	*39,000*	*Stock*	*55,000*	*72,000*
Bank overdraft	*35,000*	*25,000*	*Land & Building*	*80,000*	*1,00,000*
Outstanding expenses	*5,000*	*6,000*	*Furniture*	*15,000*	*10,000*
	1,95,000	*2,30,000*		*1,95,000*	*2,30,000*

Solution : **Fund Flow Statement**

Source of funds	₹	Application of funds	₹
Loan borrowed	10,000	Purchase of Land & Buildings	20,000
Sales of Furniture	5,000	Increase in working capital	32,000
Fund from operation	37,000		
	52,000		52,000

Working : **(*i*) Statement of changes in working capital**

	1999 ₹	2000 ₹
Current Assets:		
Cash	15,000	20,000
Debtors	30,000	28,000
Stock	55,000	72,000
Total Current Assets	1,00,000	1,20,000
Current Liabilities :		
Trade creditors	42,000	39,000
Bank overdraft	35,000	25,000
Outstanding expenses	5,000	6,000
Total current liabilities	82,000	70,000
Working capital	18,000	50,000
Increase in working capital	32,000	(18,000 – 50,000)

(*ii*) Capital Account

To Balance c/d	1,00,000	By Balance b/d	63,000
		By P.L.A/c	37,000
	1,00,000		1,00,000

Notes

(*iii*) Profit and Loss Account

To Capital Account	37,000	By Fund from operation	37,000
	37,000		37,000

Illustration 7. *Following are the comparative balance sheets of a HAL company for the year 1989 and 1990.*

Balance Sheet

Liabilities	*1989* ₹	*1990* ₹	*Assets*	*1989* ₹	*1990* ₹
Share capital	*70,000*	*74,000*	*Cash*	*9,000*	*7,800*
Debentures	*12,000*	*6,000*	*Debtors*	*14,900*	*17,700*
Creditors	*10,360*	*11,840*	*Stock*	*49,200*	*42,700*
Profit & loss A/c	*10,740*	*11,360*	*Goodwill*	*10,000*	*5,000*
			Land	*20,000*	*30,000*
	1,03,100	*1,03,200*		*1,03,100*	*1,03,200*

The following additional information is also available :

(*i*) *Dividends were paid totalling ₹ 4,000.*

(*ii*) *Land was purchased for ₹ 10,000. You are required to prepare fund flow statement.*

Solution : **Fund Flow Statement**

Source of funds	₹	Application of funds	₹
Issue of shares	4,000	Redemption of Debenture	6,000
Fund from operation	9,620	Dividend paid	4,000
Decrease in working capital	6,380	Purchase of Land	10,000
	20,000		20,000

Working : **(*i*) Statement of changes in working capital**

	1989 ₹	1990 ₹
Current Assets:		
Cash	9,000	7,800
Debtors	14,900	17,700
Stock	49,200	42,700
Total Current Assets	73,100	68,200

Notes

Current Liabilities :		
Creditors	10,360	11,840
Total current liabilities	10,360	11,840
Working capital	62,740	56,360
Increase in working capital	(62,740 – 56,360)	6,380

(*ii*) Profit and Loss Account

To Balance c/d	11,360	By Balance b/d	10,740
To Goodwill written of	5,000	By Fund from operation	9,620
To Dividend Paid	4,000		
	20,360		20,360

(*iii*) Land Account

To Balance b/d	20,000	By Balance b/d	30,000
To Cash	10,000		
	30,000		30,000

Illustration 8. *From the following balance sheets of AMB Ltd. as on 31.12.2018 and 2019, prepare a schedule of changes in working capital and fund flow statement.*

Balance Sheet

Liabilities	*2018*	*2019*
	₹	₹
Share capital	*1,00,000*	*1,00,000*
General reserve	*14,000*	*18,000*
P.L. A/c	*16,000*	*13,000*
Sundry creditors	*8,000*	*5,400*
Bills payable	*1,200*	*800*
Provision for Tax	*16,000*	*18,000*
Provision for doubtful debts	*400*	*600*
	1,55,600	*1,55,800*

Assets	*2018*	*2019*
	₹	₹
Goodwill	*12,000*	*12,000*
Buildings	*40,000*	*36,000*
Plant	*37,000*	*36,000*
Investments	*10,000*	*11,000*
Stock	*30,000*	*23,400*

Bills receivable	*2,000*	*3,200*
Debtors	*18,000*	*19,000*
Cash at bank	*6,600*	*15,200*
	1,55,600	*1,55,800*

Notes

The following additional information is also available :

1. *Depreciation charges on Plant & Buildings at ₹4,000 each.*
2. *Provision for taxation of ₹19,000 was made during the year 2019.*
3. *Interim dividend of ₹ 8,000 was paid during the year 2019.*

Solution: **Fund Flow Statement**

Source of funds	₹	Application of funds	₹
Fund from operation	36,000	Increase in working capital	7,000
		Interim dividend paid	8,000
		Tax paid	17,000
		Purchase of Plant	3,000
		Investments	1,000
	36,000		36,000

Workings: ***(i)* Statement of changes in working capital**

Current Assets :	2018	2019
Stock	30,000	23,400
Bills receivable	2,000	3,200
Debtors	18,000	19,000
Cash at Bank	6,600	15,200
Total current assets	56,600	60,800
Current Liabilities :		
Sundry creditors	8,000	5,400
Bills payable	1,200	800
Provision for Doubtful debts	400	600
Total current liabilities	9,600	6,800
Working capital	47,000	54,000
Increase in working capital	(47,000 – 54,000)	7,000

(*ii*) Profit and Loss Account

To Balance c/d	13,000	By Balance b/d	16,000
To Depreciation on Buildings	4,000	By Fund from operation	36,000
To Depreciation on Plant	4,000		
To Income tax provided	19,000		

To Interim dividend paid	8,000		
To General reserve	4,000		
	52,000		52,000

(*iii*) Provision for Taxation Account

To Balance b/d	18,000	By Balance b/d	16,000
To Cash (Tax Paid)	17,000	By PL A/c	19,000
		(Income Tax Provided)	
	35,000		35,000

(*iv*) Building Account

To Balance b/d	40,000	By Balance b/d	36,000
		By Depreciation	4,000
	40,000		40,000

(*v*) Plant Account

To Balance b/d	37,000	By Balance b/d	36,000
To Cash (Purchase)	3,000	By Depreciation	4,000
	40,000		40,000

Illustration 9. From the following balance sheets of Exe Ltd. prepare

(a) A statement of changes in working capital

(b) A fund flow statement

Liabilities	*1999* ₹	*2000* ₹	*Assets*	*1999* ₹	*2000* ₹
Equity share capital	*3,00,000*	*4,00,000*	*Good will*	*1,15,000*	*90,000*
Redeemable preference			*Land & Building*	*2,00,000*	*1,70,000*
share capital	*1,50,000*	*1,00,000*	*Plant*	*80,000*	*2,00,000*
General reserve	*40,000*	*70,000*	*Debtors*	*1,60,000*	*2,00,000*
Profit & Loss A/c	*30,000*	*48,000*	*Stock*	*77,000*	*1,09,000*
Proposed dividend	*42,000*	*50,000*	*Bills receivable*	*20,000*	*30,000*
Creditors	*55,000*	*83,000*	*Cash in hand*	*15,000*	*10,000*
Bills payable	*20,000*	*16,000*	*Cash at bank*	*10,000*	*8,000*
Provision for taxation	*40,000*	*50,000*			
	6,77,000	*8,17,000*		*6,77,000*	*8,17,000*

The following additional information is also available :

(a) Depreciation of ₹ 10,000 and ₹ 20,000 have been charged on plant and land buildings respectively in 2000.

(b) A dividend of ₹ 20,000 has been paid in 2000.

(c) Income tax of ₹ 35,000 has been paid during 2000

Notes

Solution: **Fund Flow Statement**

Source of funds	₹	Application of funds	₹
Issue of Equity shares	1,00,000	Redemption of Redeemable	50,000
Sales of Land & Building	10.000	Dividend paid	20,000
Fund from operation	2,18,000	Income tax paid	35,000
		Purchase of Plant	1,30,000
		Proposed dividend paid	42,000
		Increase in working capital	51,000
	3,28,000		3,28,000

Workings: **(*i*) Statement of changes in working capital**

	1999 ₹	2000 ₹
Current Assets :		
Debtors	1,60,000	2,00,000
Stock	77,000	1,09,000
Bills receivable	20,000	30.000
Cash in hand	15,000	10,000
Cash at Bank	10,000	8,000
Total current assets	2,82,000	3,57,000
Current Liabilities :		
Creditors	55,000	83,000
Bills payable	20,000	16,000
Total current liabilities	75,000	99,000
Working capital	2,07,000	2,58,000
Increase in working capital	51,000	(2,58,000 – 2,07,000)

(*ii*) Profit and Loss Account

To General Reserve	30,000	By Balance c/d	30.000
To Goodwill written off	25.000	By Fund from operation	2,18,000
To Depreciation on Plant	10,000		
To Depreciation of Building	20,000		
To Dividend paid	20,000		
To Balance c/d	48.000		
To Income Tax provided	45,000		
To Proposed dividend	50,000		
	2,48,000		2,48,000

Notes

(iii) Provision for Taxation Account

To Cash (Tax Paid)	35,000	By Balance b/d	40,000
To Balance c/d	50,000	By P.L. A/c	45,000
	85,000		85,000

(iv) Land & Building Account

To Balance b/d	2,00,000	By Depreciation	20,000
		By Balance c/d	1,70,000
		By Cash (Sale)	10,000
	2,00,000		2,00,000

(v) Plant Account

To Balance b/d	80,000	By Depreciation	10,000
To Cash	1,30,000	By Balance c/d	2,00,000
	2,10,000		2,10,000

Illustration 10. *The following are the summarised Balance Sheets of Lucky Ltd. as on 31.12.96 and 1997.*

Liabilities	1996 ₹	1997 ₹	Assets	1996 ₹	1997 ₹
Share capital	2.00,000	2,50,000	Land & Buildings	2,00,000	1,90,000
General reserve	50,000	60.000	Machinery	1,50,000	1,69,000
P.L. A/c	30,500	30,600	Stock	1,00,000	74,000
Bank loan (Long term)	70,000	—	Sundry debtors	80,000	64,200
Sundry creditors	1,50,000	1,35,200	Cash	500	600
Provision for taxation	30,000	35,000	Bank	—	8,000
			Goodwill	—	5,000
	5,30,500	5,10,800		5,30,500	5,10,800

Additional information supplied during the year ended 31.12.2019:

(*a*) *Dividend of ₹ 23,000 was paid.*

(*b*) *Assets of another company were purchased for a consideration of ₹ 50,000 payable in shares.*

The following assets were purchased :

Machinery ₹ 25,000 : stock ₹ 20,000.

(*c*) *Machinery was further purchased for ₹ 8,000.*

(*d*) *Depreciation written off against machinery ₹ 12,000.*

(*e*) *Income tax paid during the year ₹ 33,000.*

(*f*) *Loss on sale of machinery ₹ 200 was written off to general reserve.*

(*g*) *Depreciation charged against land & buildings was ₹ 10,000. You are required to prepare fund flow statement.*

Solution: **Fund Flow Statement**

Source of funds	₹	Application of funds	₹
Sales of Machinery	1,800	Repayment of Bank loan	70,000
Fund from operation	93,300	Dividend paid	23,000
Decrease in working capital	18,900	Purchase of Machinery	8,000
Issue of shares (For stock)	20,000	Income Tax Paid	33,000
	1,34,000		1,34,000

Notes

Workings: **(*i*) Statement of changes in working capital**

	1996 ₹	1997 ₹
Current Assets :		
Stock	1,00,000	74,000
Sundry Debtors	80,000	64,200
Cash	500	600
Bank	—	8,000
Total current assets	1,80,500	1,46,800
Current Liabilities :		
Sundry Creditors	1,50,000	1, 35,200
Total current liabilities	1,50,000	1,35,200
Working capital	30,500	11,600
Increase in working capital	18,900	(30,500 – 11,600)

(*ii*) Profit and Loss Account

To Dividend paid	23,000	By Balance b/d	30,500
To Depreciation on Machinery	12,000	By Fund from operation	93,300
To Depreciation on Land & Building	10,000		
To General Reserve	10,200		
To Income Tax (provided)	38,000		
To Balance c/d	30,600		
	1,23,800		1,23,800

(*iii*) Provision for Taxation Account

	₹		₹
To Cash	33,000	By Balance b/d	33,000
To Balance c/d	35,000	By Income (Tax provided) BF	38,000
	68,000		68,000

Notes

(iv) Machinery Account

	₹		₹
To Balance b/d	1,50,000	By Depreciation	12,000
To Shares	25,000	By General Reserve	200
To Cash (Purchase)	8,000	By Balance c/d	1,69,000
		By Cash	1,800
	1,83,000		1,83,000

(v) Goodwill Account

	₹		₹
To Balance b/d	Nil	By Balance c/d	5,000
To Share	5,000		
	5,000		5,000

(vi) General Reserve Account

	₹		₹
To Balance b/d	60,000	By Balance b/d	50,000
To Loss on sale of Machinery	200	By Profit & Loss A/c	10,200
	60,200		60,200

(vii) Land & Buildings Account

	₹		₹
To Balance b/d	2,00,000	By Depreciation	10,000
		By Balance c/d	1,90,000
	2,00,000		2,00,000

(iv) Share Capital Account

	₹		₹
To Balance c/d	2,50,000	By Balance b/d	2,00,000
		By Machinery	25,000
		By Stock	20,000
		By Goodwill	5,000
	2,50,000		2,50,000

NOTE: Total shares issued to ₹ 50,000. Among this ₹ 25,000 as against machinery and ₹ 5,000 as against goodwill. Both are non current items. It should not affect the working capital. So, only ₹ 20,000 issued as against the stock. It should be treated as a source of funds. Because, it is a current asset.

Illustration 11. *From the following summarised financial statement of Anxious Ltd as on 30.04.2018, prepare*

(*a*) *Statement of changes in working capital for the year ended 30.04.2018 and*

(*b*) *A statement showing sources and applications of funds during the same period.*

Notes

Liabilities	*2017* ₹	*2018* ₹	*Assets*	*2017* ₹	*2018* ₹
Share capital	*10,00,000*	*13,50,000*	*Fixed assets (Net)*	*18,00,000*	*20,50,000*
General reserve	*5,00,000*	*6,00,000*	*Investments*	*2,00,000*	*2,50,000*
Profit & loss A/c	*1,00,000*	*1,50,000*	*Inventories*	*5,00,000*	*7,00,000*
Debentures	*6,00,000*	*5,00,000*	*Debtors*	*5,85,000*	*6,40,000*
Sundry creditors	*9,00,000*	*10,50,000*	*Cash*	*15,000*	*10,000*
	31,00,000	*36,50,000*		*31,00,000*	*36,50,000*

During the year ended on 30.04.2018 depreciation charged on fixed assets amounted to ₹2,50,000. The final dividend for the year ended 30.04.2017 amounted to ₹1,00,000 was paid on 08.01.2018.

Solution: **Fund Flow Statement**

Source of funds	₹	Application of funds	₹
Issue of Shares	3,50,000	Purchase of fixed assets	5,00,000
Fund from operation	5,00,000	Purchase of Investments	50,000
		Dividend paid	1,00,000
		Increase in working capital	1,00,000
		Redemption of debenture	1,00,000
	8,50,000		8,50,000

Workings: **(*i*) Statement of changes in working capital**

	2018 (₹)	2019 (₹)
Current Assets :		
Inventors	5,00,000	7,00,000
Debtors	5,85,000	6,40,000
Cash	15,000	10,000
Total current assets	11,00,000	13,50,000
Current Liabilities :		
Sundry creditors	9,00,000	10,50,000
Total current liabilities	9,00,000	10,50,000
Working capital	2,00,000	3,00,000
Increase in working capital	1,00,000	(2,00,000–3,00,000)

Notes

(ii) Profit and Loss Account

	₹		₹
To General Reserve	1,00,000	By Balance b/d	1,00,000
To Dividend paid	1,00,000	By Fund from operation	5,00,000
To Depreciation	1,50,000		
To Balance c/d	2,50,000		
	6,00,000		6,00,000

(iii) Fixed Assets Account

To Balance b/d	18,00,000	By Depreciation	2,50,000
To Cash	5,00,000	By Balance c/d	20,50,000
	23,00,000		23,00,000

Illustration 12. *From the following balance sheet you are required to prepare schedule of changes in working capital and fund flow statement.*

Balance Sheet

Liabilities	*31.3.98* ₹	*31.3.99* ₹	*Assets*	*31.3.98* ₹	*31.3.99* ₹
Share capital	*50,000*	*50,000*	*Cash*	*20,000*	*10,000*
P.L. A/c	*80,000*	*1,10,000*	*Marketable securities*	*10,000*	-
12% debentures	-	*30,000*	*Investment*	*60,000*	*1,00,000*
Sundry creditors	*20,000*	*25,000*	*Debtors*	*30,000*	*40,000*
Bills payable	*20,000*	*5,000*	*Gross block*	*1,00,000*	*1,40,000*
Other current liabilities	*10,000*	*15,000*	*(–) accumulated depreciation*	*(40,000)*	*(55,000)*
	1,80,000	*2;35,000*		*1,80,000*	*2,35,000*

Solution: **Fund Flow Statement**

Source of funds	₹	Application of funds	₹
Issue of Debentures	30,000	Purchase of Gross block	40,000
Fund from operation	45,000	Increase in working capital	35,000
	75,000		75,000

Workings: **(i) Statement of changes in working capital**

Current Assets :	31.3.98 (₹)	31.3.99 (₹)
Cash	20,000	10,000
Marketable securities	10,000	-
Inventories	60,000	1,00,000
Debtors	30,000	40,000

Total current assets	1,20,000	1,50,000
Current Liabilities :		
Sundry creditors	20,000	25,000
Bills payable	20,000	5,000
Other Current Liabilities	10,000	15,000
Total current liabilities	50,000	45,000
Working capital	70,000	1,05,000
Increase in working capital	35,000	(70,000 – 1,05,000)

(*ii*) Profit and Loss Account

To Depreciation	15,000	By Balance b/d	80,000
To Balance c/d	1,10,000	By Fund from operation	45,000
	1,25,000		1,25,000

NOTE: Gross Block means total fixed assets.

Illustration 13. *The following are the summarized balance sheets of KNP Ltd. on 31st December 2002 and 2003.*

Liabilities	*2002*	*2003*	*Assets*	*2002*	*2003*
	₹	₹		₹	₹
Share capital	*12,00,000*	*16,00,000*	*Plant & Machinery*	*8,00,000*	*12,90,000*
Debentures	*4,00,000*	*6,00,000*	*Land & building*	*6,00,000*	*8,00,000*
Profit & loss A/c	*2,50,000*	*5,00,000*	*Stock*	*6,00,000*	*7,00,000*
Creditors	*2,30,000*	*1,80,000*	*Bank*	*40,000*	*80,000*
Provision for Bad & doubtful debts	*12,000*	*6,000*	*Preliminary Expenses*	*14,000*	*12,000*
Depreciation on land & building	*40,000*	*48,000*			
Depreciation on plant & machinery	*60,000*	*70,000*			
	21,92,000	*30,04,000*		*21,92,000*	*30,04,000*

The following adjustments are to be made:

1. *During the year a part of machinery costing ₹ 1,40,000 (accumulated depreciation there on ₹ 4,000) was sold for ₹ 12,000.*
2. *Dividend of ₹ 1,00,000 was paid during the year.*

   Prepare : (a) statement of changes in working capital, (b) Fund flow statement

Notes

Solution: **Fund Flow Statement**

Source of funds	₹	Application of funds	₹
Issue of Shares	4,00,000	Dividend paid	1,00,000
Issue of Debentures	2,00,000	Purchase of Plant & Machinery	6,30,000
Sales of Machinery	12,000	Purchase of Land & Building	2,00,000
Fund from operation	4,98,000		
		Increase in working capital	1,80,000
	11,10,000		11,10,000

Workings: **(*i*) Statement of changes in working capital**

	2002 (₹)	2003 (₹)
Current Assets :		
Stock	6,00,000	7,00,000
Bank	40,000	80,000
Debtors	1,38,000	1,22,000
Total current assets	7,78,000	9,02,000
Current Liabilities :		
Creditors	2,30,000	1,80,000
Provision for doubtful debts	12,000	6,000
Total current liabilities	2,42,000	1,86,000
Working capital	5,36,000	7,16,000
Increase in working capital	1,80,000	(5,36,000 – 7,16,000)

(*ii*) Profit and Loss Account

To Depreciation :		By Balance b/d	2,50,000
Plant & Machinery	14,000	By Fund from operation	4,98,000
Land & Building	8,000		
To Preliminary Expenses			
Written off	2,000		
To Dividend paid	1,00,000		
To Loss on sale of Machinery	1,24,000		
To Balance c/d	5,00,000		
	7,48,000		7,48,000

(*iii*) Plant and Machinery Account

To Balance b/d	8,00,000	By Cash	12,000
To Cash (Purchase)	6,30,000	By Accumulated Depreciation	4,000
		By Profit & Loss A/c	1,24,000
		By Balance c/d	12,90,000
	14,30,000		14,30,000

Notes

(*iv*) Accumulated Depreciation Account on Plant & Machinery

To Balance c/d	70,000	By Balance b/d	60,000
To Machinery A/c	4,000	By Profit & Loss A/c	
		(Current year Depreciation)	14,000
	74,000		74,000

(*v*) Land & Buildings A/c

To Balance b/d	6,00,000	By Balance c/d	8,00,000
To Cash	2,00,000		
	8,00,000		8,00,000

(*vi*) Accumulated Depreciation Account on Land & Building

To Balance c/d	48,000	By Balance c/d	40,000
		By Profit & Loss A/c	8,000
	48,000		48,000

NOTE :

Journal Entry for Ist Adjustment

Cash A/c	Dr.	12,000		[Sale of machinery]
Accumulated depreciation A/c	Dr.	4,000		[Depreciation]
Profit and Loss A/c	Dr.	1,24,000		[Loss on sale of machinery]
To machinery A/c			1,40,00	[Cost of machinery]

Illustration 14. *From the following balance sheets of a Indian Company Ltd. you are required to prepare fund flow statement.*

Liabilities	*Jan. 2002* ₹	*Dec. 2002* ₹	*Assets*	*Jan. 2002* ₹	*Dec. 2002* ₹
Current Liabilities	*30,000*	*32,000*	*Cash*	*40,000*	*44,400*
Bonds payable	*22,000*	*22,000*	*Accounts receivable*	*10,000*	*20,700*
Bonds Payable discount	*(2000)*	*(1,800)*	*Inventories*	*15,000*	*15,000*
Capital stock	*35,000*	*43,500*	*Land*	*4,000*	*4,000*
Retained earnings	*15,000*	*19,500*	*Buildings*	*20,000*	*16,000*
			Equipment	*15,000*	*17,000*
			Accumulated Depreciation	*(5,000)*	*(2,800)*
			Patents	*1,000*	*900*
	1,00,000	*1,15,200*		*1,00,000*	*1,15,200*

Notes

The following additional information is also available:

(*a*) *Income for the period ₹ 10,000.*

(*b*) *A building that costs ₹ 4,000 and which had a book value of ₹ 1,000 was sold for ₹ 1,400.*

(*c*) *The depreciation charged for the period was ₹ 800.*

(*d*) *There was an issue of common stock ₹ 5,000.*

(*e*) *Cash dividend of ₹ 2,000 and ₹ 3,500 stock dividend were declared.*

Solution: **Fund Flow Statement**

Source of funds	₹	Application of funds	₹
Sale of Building	1,400	Purchase of equipment	2,000
Issue of Common stock	5,000	Cash dividend paid	2,000
Fund from operation	10,700	Increase in working capital	13,100
	17,100		17,100

Workings: **(*i*) Statement of changes in working capital**

Current Assets :	Jan. 2002 (₹)	Dec. 2002 (₹)
Cash	40,000	44,400
Account receivable	10,000	20,700
Inventories	15,000	15,000
Total current assets	65,000	80,100
Current Liabilities :		
Current Liabilities	30,000	32,000
Total current liabilities	30,000	32,000
Working capital	35,000	48,100
Increase in working capital [48,100 – 35,000]	—	13,100

(*ii*) Profit and Loss Account

To Loss on Bond Payable discount	200	By Balance b/d	15,000
To Patent written off	100	By Profit on sale of Building	400
To Cash dividend paid	2,000	By Fund from operation	10,700
To Depreciation	800		
To Stock dividend	3,500		
To Balance c/d	19,500		
	26,100		26,100

Notes

(*iii*) Capital Stock Account

To Balance c/d	43,500	By Balance c/d	35,000
		By Cash	5,000
		By Stock Dividend	3,500
	43,500		43,500

(*iv*) Accumulated Depreciation Account

To Balance c/d	2,800	By Balance b/d	5,000
To Buildings A/c	3,000	By Profit & Loss A/c	800
	5,800		5,800

(*v*) Buildings A/c

To Balance b/d	20,000	By Cash	1,400
To Profit & Loss A/c (Profit on sale)	400	By Accumulated Depreciation	3,000
		By Balance c/d	16,000
	20,400		20,400

NOTE :

Journal Entry for IInd Adjustment

Cash A/c	Dr.	1,400		[Sale of Building]
Accumulated depreciation A/c	Dr.	3,000		[Depreciation]
To Building A/c			4,000	[Book value]
Profit and Loss A/c			400	[Profit]

illutration 15. *From the following balance sheets of Kavin Ltd., prepare a statement of changes in working capital and fund flow statement for the year ended 31.3.2002.*

Liabilities	*2001*	*2002*	*Assets*	*2001*	*2002*
	₹	₹		₹	₹
Share capital	*3,00,000*	*3,50,000*	*Goodwill*	*1,00,000*	*80,000*
Debentures	*1,50,000*	*2,50,000*	*Machinery*	*4,10,000*	*5,40,000*
General reserve	*1,00,000*	*1,50,000*	*Investment*	*30,000*	*80,000*
Profit & loss A/c	*60,000*	*70,000*	*Discount on issue of Debentures*	*5,000*	—
Provision for depreciation on machinery	*90,000*	*1,30,000*	*Cash at bank*	*1,20,000*	*1,30,000*
Sundry creditors	*75,000*	*1,10,000*	*Sundry debtors*	*80,000*	*1,90,000*
Bills payable	*10,000*	*15,000*	*Stock*	*40,000*	*55,000*
	7,85,000	*10,75,000*		*7,85,000*	*10,75,000*

During the year investments costing ₹ 30,000 were sold for ₹ 28,000 and a new machine was purchased for ₹ 45,000. The payment was made in fully paid shares.

Notes

Solution: **Fund Flow Statement**

Source of funds	₹	Application of funds	₹
Issue of shares	5,000	Purchase of Machinery (4)	85,000
Issue of Debentures	1,00,000	Increase in Working Capital (1)	95,000
Sale of investments	28,000	Purchase of Investment (6)	80,000
Fund from operation	1,27,000		
	2,60,000		2,60,000

Workings: **(*i*) Statement of changes in working capital**

	1999 (₹)	2000 (₹)
Current Assets :		
Cash at bank	1.20,000	1,30,000
Sundry Debtors	80,000	1,90,000
Stock	40,000	55,000
Total current assets	2,40,000	3,75,000
Current Liabilities :		
Sundry creditors	75,000	1,10,000
Bills payable	10,000	15,000
Total current liabilities	85,000	1,25,000
Working capital	1,55,000	2,50,000
Increase in working capital	95,000	(1,55,000 – 2,50,000)

(*ii*) Profit and Loss Account

To Goodwill written off	20,000	By Balance b/d	60,000
To General Reserve	50,000	By Fund from operation	1.27,000
To Discount issue of Debentures	5,000		
To Depreciation	40.000		
To Loss on Sale of Investments	2,000		
To Balance c/d	70,000		
	1.87,000		1,87,000

(*iii*) Share Capital Account

To Balance c/d	3,50,000	By Balance b/d	3,00,000
		By Machinery	45,000
		By Cash	5,000
	3,50,000		3,50,000

Notes

(*iv*) Machinery Account

To Balance b/d	4,10,000	By Balance c/d	5,40,000
To Shares	45,000		
To Cash (b/f)	85,000		
	5,40,000		5,40,000

(*v*) Provision for Depreciation on Machinery Account

To Balance b/d	30,000	By Bank	28,000
To Purchase of Investment (b/f)	80,000	By Loss Sale of Investment	2,000
		By Balance c/d	80,000
	1,10,000		1,10,000

NOTE : Sale of Investment

Cash A/c	Dr.	28,000		[Actual sale]
Profit & Loss A/c	Dr.	2,000		[Loss on sale]
To Investments			30,000	[Value of investment]

Illustration 16. *From the following summarised balance sheets of Balaji & Co. as on 31.12.2003 and other information furnished, prepare fund flow statement.*

Balance sheet

Liabilities	*2003* ₹	*2002* ₹	*Assets*	*2003* ₹	*2002* ₹
Share capital	*2,00,000*	*50,000*	*Fixed assets*	*4,20,000*	*2,40,000*
Redeemable per shares	—	*1,00,000*	*Investments*	*15,000*	*18,000*
Profit & loss A/c	*3,50,000*	*1,20,000*	*Stock*	*1,60,000*	*58,500*
Debentures	—	*1,25,000*	*Bills receivable*	*92,000*	*1,37,000*
Sundry creditors	*1,90,000*	*2,25,000*	*Cash at bank*	*1,20,000*	*1,85,000*
Provision for Tax	*75,000*	*25,000*	*Prepaid expenses*	*8,000*	*6,500*
	8,15,000	*6,45,000*		*8,15,000*	*6,45,000*

The following additional information is also available :

(*a*) *On 31.12.2003 accumulated depreciation on fixed assets amounted to ₹ 1,20,000 and on 31st December 2002 ₹ 1,10,000*

(*b*) *Machinery costing ₹ 10,000 (accumulated depreciation thereon being ₹ 5,000) was discarded and written off during 2003.*

(*c*) *Depreciation written off during 2003 amounted to ₹ 15,000.*

(*d*) *During the year 2003 investments costing ₹ 6,000 were sold for ₹ 7,000.*

(*e*) *Dividend paid during the year was ₹ 45,000*

(*f*) *Redeemable preference shares were redeemed out of profits during the year at a premium of 5%.*

Notes

Solution: **Fund Flow Statement**

Source of funds	₹	Application of funds	₹
Issue of shares	1,50,000	Repayment of Secured Loan	1,25,000
Sales of investments	7,000	Dividend paid	95,000
Decrease in working capital	22,000	Redemption of preference	
Fund from operation	2,99,000	Share	1,05,000
		Purchase of Investments	3,000
		Purchase of Fixed assets	2,00,000
	4,78,000		4,78,000

Workings: **(i) Statement of changes in working capital**

	2002 (₹)	2003 (₹)
Current Assets :		
Stock	58,500	1,60,000
Sundry Debtors	1,37,000	92,000
Cash at Bank	1,85,000	1,20,000
Prepaid expenses	6,500	8,000
Total current assets	3,87,000	3,80,000
Current Liabilities :		
Sundry creditors	2,25,000	1,90,000
Provision for tax	25,000	75,000
Total current liabilities	2,50,000	2,65,000
Working capital	1,37,000	1,15,000
Increase in working capital	22,000	(1,37,000 – 1,15,000)

(ii) Profit and Loss Account

	₹		₹
To Loss on sale of Machinery	5,000	By Balance b/d	1,20,000
To Dividend paid	45,000	By profit on sale of Investment	1,000
To Premium on Redemption of Preference share	5,000	By Fund from operation	2,99,000
To Depreciation	15,000		
To Balance c/d	3,50,000		
	4,20,000		4,20,000

(iii) Redeemable Preference Share Capital Account

To Cash	1,05,000	By Balance b/d	1,00,000
		By P & L A/c (premium)	5,000
	1,05,000		1,05,000

(*iv*) Fixed Assets Account

To Balance b/d (2,40,000 + 1,10,000)	3,50,000	By P & L A/c	5,000
To Cash	2,00,000	By Accumulated Depreciation	5,000
		By Balance c/d (4,20,000 + 1,20,000)	
	5,50,000		5,50,000

(*v*) Accumulated Depreciation Account

To Fixed Assets	5,000	By Balance b/d	1,10,000
		By P& L A/c (Current year Depreciation)	15,000
To Balance c/d	1,20,000		
	1,25,000		1,25,000

(*vi*) Investment Account

To Balance b/d	18,000	By Cash	6,000
To Cash	3,000	By Balance c/d	15,000
	21,000		21,000

NOTE :

(*i*) Journal Entry for IInd Adjustment

Profit & Loss A/c	Dr.	5,000		[Loss]
Accumulated depreciation A/c	Dr.	5,000		[Depreciation]
To machinery A/c			10,000	[Value of machinery]

(*ii*) Journal Entry for IV Transaction

Cash A/c	Dr.	7,000	
To Profit & Loss A/c			1,000
To Investment A/c			6,000

(*iii*) Here, provisional for Taxation assumed to current liability

Illustration 17. *From the following data of National Auto Ltd. for the year 2000 and 2001. Particulars*

Liabilities	*2000*	*2001*
	₹	₹
Cash	*2,000*	*2,500*
Account receivable	*2,400*	*2,700*
Inventories	*3,100*	*3,200*
Other current assets	*800*	*700*
Fixed assets	*5,000*	*5,800*
Accumulated depreciation	*2,100*	*2,500*
Accounts payable	*2,000*	*2,100*
Long term debt	*1,400*	*1,300*

Equity capital	*5,000*	*5,300*
Retained earnings	*2,800*	*3,700*

The following additional information is also available :

Notes

(*a*) *Fixed assets costing ₹1,200 were purchased for cash.*

(*b*) *Fixed assets [Original cost of ₹400 accumulated depreciation ₹150] were sold for ₹ 200.*

(*c*) *Depreciation for the year 2001 amounted to ₹ 550 and duly debited to profit & loss account.*

(*d*) *Dividend paid amounted to ₹dd 300 in 2001.*

(*e*) *Reported income for 2001 was ₹ 2,400.*

Solution: **Fund Flow Statement**

Source of funds	₹	Application of funds	₹
Issue of Equity Shares	300	Dividend paid	300
Sale of Fixed Assets	200	Purchase of Fixed Assets	1,200
Fund from operation	1,800	Repayment of Long term Debt	100
		Increase in working capital	700
	2,300		2,300

Workings: **(*i*) Statement of changes in working capital**

	2000 (₹)	2001 (₹)
Current Assets :		
Cash	2,000	2,500
Accounts receivable	2,400	2,700
Inventories	3,100	3,200
Other current assets	800	700
Total current assets	8,300	9,100
Current Liabilities :		
Account payable	2,000	2,100
Total current liabilities	2,000	2,100
Working capital	6,300	7,000
Increase in working capital	700	(6300 – 7000)

(*ii*) Fixed Assets Account

To Balance b/d	5,000	By Cash	200
To Cash	1,200	By Accumulated Depreciation	150
		By Profit & Loss A/c	50
		By Balance c/d	5,800
	6,200		6,200

(*iii*) Profit and Loss Account

To Fixed Assets	50	By Balance c/d	2,800
To Depreciation	550	By Fund from operation	1,800
To Dividend paid	300		
To Balance c/d	3,700		
	4,600		4,600

(*iv*) Accumulated Depreciation Account

To Fixed Assets	150	By Balance b/d	2,100
To Balance c/d		By Profit & Loss A/c	550
	2,500		2,650

Notes

NOTE :

(*i*) Journal Entry for IInd Adjustment

Cash A/c	Dr.	200		[Sale of fixed assets]
Accumulated depreciation A/c	Dr.	150		[Depreciation]
Profit and Loss A/c	Dr.	50		[Loss on sale]
To Fixed assets			400	

(*ii*) Reported income

It is included in the Retained Earnings. So, there is no need to give the effect of this Adjustment.

Illustration 18. From the following information, calculate funds from operations.

Profit and Loss Account

To expenses	₹		₹
To Operating expenses	*1,00,000*	*By Gross profit*	*2,00,000*
To Depreciation	*40,000*	*By Gain on sale of building*	*20,000*
To loss on sale of machinery	*10,000*		
To advertisement expenses A/c	*5,000*		
To discount of debtors	*500*		
To discount on issue a shares	*500*		
To goodwill written off	*12,000*		
To preliminary expenses written off	*2,000*		
To Net profit	*50,000*		
	2,20,000		*2,20,000*

Solution:

Notes

Computation of fund from operation Profit & Loss Account

To expenses	₹	Incomes	₹
To Depreciation	40,000	By Balance b/d	Nil
To Loss on sale of Machinery	10,000	By Gain on sale of Buildings	20,000
To Goodwill written off	12,000	By Fund from operation	99,500
To Advertisement Expenses	5,000		
To Discount allowed	500		
To Preliminary Expenses Written off	2,000		
To Balance c/d	50,000		
	1,19,500		1,19,500

Illustration 19. *Balance sheets of M/s Black and White as on 1st Jan. 2000 and 31st Dec 2000 were as follows:*

Liabilities	*Jan. 2000* ₹	*Dec. 2000* ₹	*Assets*	*Jan. 2000* ₹	*Dec. 2000* ₹
Creditors	*40,000*	*44,000*	*Cash*	*10,000*	*7,000*
White's loan	*25,000*	—	*Debtors.*	*30,000*	*50,000*
Loan from bank	*40,000*	*50,000*	*Stock*	*35,000*	*25,000*
Capital	*1,25,000*	*1,53,000*	*Land*	*40,000*	*50,000*
			Buildings	*35,000*	*60,000*
			Machinery	*80,000*	*55,000*
	2,30,000	*2,47,000*		*2,30,000*	*2,47,000*

During the year machine costing ₹ 10,000 [accumulated depreciation ₹ 3,000] was sold for ₹ 5,000. The provision for depreciation against machinery as on 1st Jan 2000 was ₹ 25,000 and on 31st Dec 2000 ₹ 40,000. Net profit for the year 2000 amounted to ₹ 45,000. Prepare fund flow statement.

Solution: **Fund Flow Statement**

Source of funds	₹	Application of funds	₹
Loan from PN Bank	10,000	Repayment of Mr. White's Loan	25,000
Sales of Machinery	5,000	Purchase of Land	10,000
Fund from operation	65,000	Purchase of Building	25,000
		Increase in working capital	3,000
		Drawings (Capital A/c)	17,000
	80,000		80,000

Workings: **(*i*) Statement of changes in working capital**

Current Assets :	1.1.2002 (₹)	31.12.2002 (₹)
Cash	10,000	7,000

Debtors	30,000	50,000
Stock	35,000	25,000
Total current assets	75,000	82,000
Current Liabilities :		
Creditors	40,000	40,000
Total current liabilities	40,000	44,000
Working capital	35,000	38,000
Increase in working capital	3,000	(35,000 – 38,000)

Notes

(*ii*) Profit and Loss Account

To Loss on sale of Machinery	2,000	By Fund from operation	65,000
To Depreciation	18,000		
To Balance c/d	45,000		
	65,000		65,000

(*iii*) Capital Account

To Balance c/d	1,53,000	By Cash	5,000
To Cash (b/f)	17,000	By Profit & Loss A/c	45,000
	1,70,000		1,70,000

(*iv*) Machinery A/c

To Balance c/d (80,000 + 25,000)	1,05,000	By Cash	5,000
		By P & L A.c	2,000
		By Accumulated Depreciation	3,000
		By Balance c/d	95,000
	1,05,000		1,05,000

(*iv*) Accumulated Depreciation Account

To Machinery A/c	3,000	By Balance b/d	25,000
To Balance c/d	40,000	By P & L A/c (b/f)	18,000
	43,000		43,000

NOTE :

Journal Entry for Ist Adjustment

Cash A/c	Dr.	5,000	
Accumulated depreciation A/c	Dr.	3,000	
Profit and Loss A/c	Dr.	2,000	
To Machinery A/c			10,000

Illustration 20. *The Balance sheets of Dharan Ltd. as on 31.12.1999 and 31.12.2000 are as follows.*

Liabilities	1999 ₹	2000 ₹	Assets	1999 ₹	2000 ₹
Share capital	2,00,000	2,50,000	Fixed assets	3.50.000	4,75,000
Retained earnings	1.60.000	3,00,000	Inventory	1,00,000	95,000
Premium on share	—	5.000	Accounts receivable	43,000	50,000
Accumulated depreciation	80,000	60.000	Prepaid expenses	4,000	5,000
Debentures	60,000	—	Cash	15,800	10,200
Bank overdraft	37,800	40.200	Commission on shares	25,000	20,000
	5,37,800	6,55,200		5.37,800	6,55,200

The following additional information is also available :

(*i*) Net profit for the year ₹ 1,40,000

(*ii*) Income tax was paid ₹ 40,000

(*iii*) Interim dividend paid during the year was ₹ 20,000.

(*iv*) An addition to the fixed asset was made during the year at a cost of ₹ 1,65,000 and fully depreciated machinery costing ₹ 40.000 was discarded, no salvage being realised.

(*v*) Depreciation for the year ₹ 20,000

Solution: **Fund Flow Statement**

Source of funds	₹	Application of funds	₹
Issue of Shares	50,000	Redemption of debentures	60,000
Premium on shares received	5,000	Purchase of Fixed Assets	1,65,000
Fund from operation	2,25,000	Income Tax paid	40,000
Decreasing in working capital	5,000	Interim dividend paid	20,000
	2,85,000		2,85,000

Workings: **(*i*) Statement of changes in working capital**

	1999 (₹)	2000 (₹)
Current Assets :		
Inventories	1,00,000	95,000
Accounts receivable	43,000	50,000
Prepaid expenses	4,000	5,000
Cash	15,800	10,200
	1,62,800	1,60,200
Current Liabilities :		
Bank overdraft	37,800	40,200
Total current liabilities	37,800	40,200
Working capital	1,25,000	1,20,000
Decrease in working capital	5,000	[1,25,000 – 1,20,000]

Notes

(ii) Profit and Loss Account

	₹		₹
To Commission on shares written off	5,000	By Balance b/d	1,60,000
To Depreciation	20,000	By Fund from operation (b/f)	2,25,000
To Income Tax paid	40,000		
To Interim dividend paid	20,000		
To Balance c/d	3,00,000		
	3,85,000		3,85,000

(iii) Fixed Assets Account

To Balance b/d	3,50,000	By accumulated depreciation	40,000
To Cash (b/f)	1,65,000	By Balance c/d	4,75,000
	5,15,000		5,15,000

(iv) Accumulated Depreciation Account

To Machinery A/c (Fully Depreciated Machinery)	40,000	By Balance b/d	80,000
To Balance c/d	60,000	By Profit & Loss A/c (b/f)	20,000
	1,00,000		1,00,000

Illustration 21. *Following are the summarized Balance Sheet of XYZ Ltd. As on 31st Dec. 2002 and 2003.*

Liabilities	*2002* ₹	*2003* ₹	*Assets*	*2002* ₹	*2003* ₹
Share Capital	*1,00,000*	*1,25,000*	*Land and Building*	*1,00,000*	*95,000*
General Reserve	*25,000*	*30,000*	*Machinery*	*75,000*	*84,500*
Profit and Loss A/c	*15,250*	*15,300*	*Stock*	*50,000*	*37,000*
Bank loan (long-term)	*35,000*	----	*Debtors*	*40,000*	*32,100*
Sundry Creditors	*75,000*	*67,600*	*Cash*	*250*	*300*
Provision for Taxation	*15,000*	*17,500*	*Bank*	----	*4,000*
			Goodwill	----	*2,500*
	2,65,250	*2,55,400*		*2,65,250*	*2,55,400*

Additional Information :

(i) *Dividend of ₹ 16,500/- was paid.*

(ii) *Assets of another company were purchased for a consideration of ₹ 25,000/- payable in shares.*

The following assets purchased

Stock *10,000*

Machinery *12,500*

(iii) *Machinery was further purchased for ₹ 4,000*

(iv) *Depreciation written off on machinery ₹ 6,000*

(v) *Income tax provided during the year ₹ 16,500/-*

(vi) *Loss on sale of machinery ₹ 100/- was written off to General Reserve. Prepare a statement of Funds Flow of XYZ Ltd.*

Notes

Solution: **Fund Flow Statement**

Source of funds	₹	Application of funds	₹
Sale of land and buildings	5,000	Repayment of bank loan	35,000
Funds from operation	44,150	Dividend paid	16,500
Sale of machinery	900	Purchase of machinery	4,000
Decrease in working capital	9,450	Income tax paid	14,000
Issue of shares for stock	10,000		
	69,500		69,500

Workings :

1. **Statement of changes in working capital :**

	2002 (₹)		2003 (₹)
Current Assets :			
Stock	50,000		37,000
Debtors	40,000		32,100
Cash	250		300
Bank	---		4,000
Total current assets	90,250		73,400
Current Liabilities :			
Sundry creditors	75,000		67,600
Total current liabilities	75,000		67,600
Working capital	15,250		5,800
Decrease in working capital		9,450	

2. **Share Capital A/c**

	₹		₹
To Balance c/d	1,25,000	By Balance b/d	1,00,000
		By Stock	10,000
		By Machinery	12,500
		By Goodwill	2,500
	1,25,000		1,25,000

Notes

3. **Profit and Loss A/c**

	₹		₹
To Balance c/d	15,300	By Balance b/d	15,250
To Dividend paid	16,500	By FFO	44,150
To Depreciation (mach)	6,000		
To Income tax provision	16,500		
To General Reserves	5,100		
	59,400		59,400

4. **Provision for Taxation A/c**

	₹		₹
To Balance c/d	17,500	By Balance b/d	15,000
To Cash (Tax paid)	14,000	By P.L. A/c	16,500
	31,500		31,500

5. **Machinery A/c**

	₹		₹
To Balance b/d	75,000	By Balance c/d	84,500
To Shares	12,500	By Profit and loss A/c	6,000
To Cash	4,000	By General Reserve A/c	100
		By Cash	900
	91,500		91,500

6. **Goodwill A/c**

	₹		₹
To Balance b/d	Nil	By Balance c/d	2,500
To Shares	2,500		
	2,500		2,500

7. **General Reserve A/c**

	₹		₹
To Balance c/d	30,000	By Balance b/d	25,000
To Machinery	100	By Profit and Loss A/c	5,100
	30,100		30,100

5.14. Review Exercise

1. Babu & Co. presents the following Financial Statement for 1988 and 1989. Prepare a sources and application for funds statement.

Notes

Liabilities	1988 ₹	1989 ₹	Assets	1988 ₹	1989 ₹
Bills payable	4,52,000	6,28,000	Cash	1,06,000	62,000
Creditors	8,26,000	12,54,00	Investment	1,74,000	–
Loan from bank	2,00,000	4,70,000	Debtors	6,92,000	10,56,000
Receives & Surplus	13,84,000	17,28,000	Stock	8,64,000	13,66,000
Share capital	12,00,000	12,00,000	Net fixed assets	22,26,000	27,96,000
	40,62,000	**52,80,000**		**40,62,000**	**52,80,000**

Depreciation of ₹ 3,78,000 was written off for the year 1989 on fixed assets.

[**Ans.** Increase in working capital ₹ 2,18,000]

2. Balance Sheets of M/s. Raman and Krishna as on 1st January, 1989 and 31 st December 1998 were as follows:

Balance Sheet

Liabilities	1.1.98 ₹	31.12.98 ₹	Assets	1.1.98 ₹	31.12.98 ₹
Bill Payable	80,000	88,000	Cash	25,000	22,000
Mrs. Krishnan's laon	50,000	–	Debtors	30,000	80,000
Loan, secured on Building	80,000	80,000	Stock	75,000	40,000
Creditors	30,000	60,000	Bills Receivable	25,000	30,000
Capitals:			Building	1,00,000	90,000
Raman	40,000	50,000	Furniture	1,05,000	86,000
Krishnan	80,000	70,000			
	3,60,000	**3,48,000**		**3,60,000**	**3,48,000**

During 1998, furniture costing 10,000 (accumulated depreciation ₹ 6,000) was sold for ₹ 3,000.

Net profit for the year was ₹ 80,000, divided equally to the partners.

Prepare a statement of sources and uses of funds for the year 1998.

[**Ans.** Decrease in working capital ₹ 21,000]

3. Balance Sheet of Ganesh Mills Ltd.

Liabilities	1992 ₹	1993 ₹	Assets	1992 ₹	1993 ₹
Equity share capital	3,00,000	4,00,000	Building	2,50,000	3,00,000
10% Redeemable per share capital	2,00,000	–	Machinery	3,00,000	3,20,000
Capital Redemption			Furniture	20,000	18,000
Reserve	–	1,00,000	Investments	1,00,000	1,50,000

Reserve Fund	2,00,000	1,20,000	Debtors	1,40,000	2,00,000
Share Premium	30,000	30,000	Cash at Bank	20,000	32,000
Profit & Loss A/c	1,20,000	1,80,000			
12% Debentures	2,00,000	3,00,000			
Creditors	80,000	1,40,000			
	11,30,000	**12,70,000**		**11,30,000**	**12,70,000**

Notes

The following transaction took place during the year 1993:

(*a*) Preference shares were redeemed at 10% premium.

(*b*) ₹ 20,000 was transferred to Reserve Fund from P & L A/c.

(*c*) Investments (book value ₹ 40,000) were sold for ₹ 70,000.

(*d*) Depreciation provided on Building, Machinery and Furniture ₹ 20,000, ₹ 30,000 and ₹ 2,000 respectively.

(*e*) Dividends paid ₹ 50,000 and income tax paid ₹ 45,000. Prepare a funds flow statement showing change in working capital.

[**Ans.** Decrease in working capital ₹ 38,000]

4. From the following prepare a statement showing changes in working capital during 2002

Balance Sheet

as on 31st December

Liabilities	2001	2002	Assets	2001	2002
	₹	₹		₹	₹
Share capital	5,00,000	6,00,000	Fixed Assets	10,00,000	11,20,000
Reserves	15,00,00	1,80,000	Less: Depreciation	3,70,000	4,60,000
P&L Amount	40,000	65,000		6,30,000	6,60,000
Debentures	3,00,000	2,50,000	Stock	2,40,000	3,70,000
			Book debts	2,50,000	2,30,000
Creditors for good	1,70,000	1,60,000	Cash in hand and at bank	80,000	60,000
Provision for			Preliminary exp.	20,000	15,000
Income tax	60,000	1,80,000			
	12,20,000	**13,35,000**		**12,20,000**	**13,35,000**

[**Ans.** Increase in working capital ₹ 1,00,000]

5. Prepare a statement of changes in working capital from the following details of 'R' Ltd.

Liabilities	31.12.99	31.12.2000	Assets	31.12.99	31.12.99
	₹	₹		₹	₹
Equity capital	5,00,000	5,00,000	Fixed Assets	6,00,000	7,00,000
Debentures	3,70,000	4,50,000	Long-term		

Notes

Tax payable	77,000	43,000	Investments	2,00,000	1,00,000
Creditors	96,000	1,92,000	Work-in-progress	80,000	90,000
Dividend payable	87,000	80,000	Stock	1,50,000	2,25,000
			Debtors	70,000	1,40,000
			Cash	30,000	10,000
	11,30,000	12,65,000		11,30,000	12,65,000

[**Ans.** Increase in working capital ₹ 80,000]

6. Finds fund from operations from the following data:

Opening balance of P&L A/c	₹ 60,000
Closing balance of P&L	₹ 30,000

The following items appeared in P&L A/c:

Interim divided paid ₹ 20,000, proposed divided ₹ 30,000, depreciation ₹ 50,000, Preliminary expenses ₹ 1,000, loss on sale of machinery ₹ 3,000, General Reserve ₹, 5,000, sinking fund ₹ 10,000, salaries paid ₹ , 3,000, profit on sale of car ₹ 4,000, and tax paid ₹ 5,000.

[Ans. Funds from operation ₹ 90,000]

7. From the following, compute the funds from operation

Profit and Loss Account

	₹		₹
To cash Purchase	50,000	By sales	60,000
To Gross Profit c/d	10,000		
	60,000		60,000
To Salaries	8,000	By Gross Profit b/d	10,000
To Rent	7,000	By Dividends received	3,000
To Depreciation	2,000	By Interest Investments	3,000
To Goodwill written off	1,000	By Net Loss	4,000
To Preliminary expenses written off	500		
To Discount on issue of Debentures	1,500		
	20,000		**20,000**

[**Ans.** Funds outflow account of operation ₹ 5,000]

8. From the following details, calculate funds from operations

Particulars	₹
Salaries	5,000
Rent	3,000
Depreciation on Plant	5,000
Provision for tax	4,000
Loss on sale of Plant	2,000
Opening balance of P & L A/c	25,000

Transfer of General Reserve	1,000
Goodwill written off	2,000
Dividend Received	5,000
Refund of tax	3,000
Profit on sale of building	5,000
Closing balance of P & L A/c	60,000
Discount on issue of debentures	2,000
Provision for bad debts	1,000
Preliminary expenses written off	3,000
Proposed divided	6.000

[**Ans.** Funds from operation ₹ 47,000]

9. The followings is the comparative Balance Sheet of A Ltd. Prepare a Funds Flow Statement:

Balance Sheet

Liabilities	31.12.05	31.12.05	Assets	31.12.05	31.12.05
	₹	₹		₹	₹
Share capital	8.000	8,500	Land	5.000	5,000
P&L Appn. A/c	1,450	2,450	Plant	2,400	3,400
Creditors	900	500	Debtors	1,650	1,950
Mortgage loan	–	500	Stock	900	700
			Cash at Bank	400	900
	10,350	**11,950**		**10,350**	**11,950**

[**Ans.** Increase in working capital: ₹ 1.000;
Total sources: ₹ 2,000; Applications:
₹ 1,000; Funds from operations: ₹ 1000]

10. From the following Balance Sheets of Arun Ltd. Prepare a sources and uses of funds statement for 2005.

	31.12.05	31.12.04
	₹	₹
Assets		
Cash	75,000	35.000
Debtors	90,000	98,000
Stock & work-in-progress	1,20,000	87,000
Long term investments	10,000	15.000
Land	30,000	20,000
	3,25,000	**2,55,000**

Liabilities :

Account payable	45,000	50,000
Notes payable (short-term)	35,000	20,000
Notes payable (due Dec. 206)	20,000	–
Capital Stock	1,50,000	1,25,000
Retained earnings	75,000	60,000
	3,25,000	**2,55,000**

[**Ans.** Increase in working capital: ₹ 35,000;
Total sources: ₹ 45,000; Applications: ₹ 10,000;
Funds from operations: ₹ 15,000]

11. The Balance Sheet of Swatantra Bharat Co. Ltd. As at 31st December 1991 and 1992 are given below:

	1991	1992
	₹	₹
Assets		
Freehold land	1,00,000	1,00,000
Plant at cost	1,04,000	1,00,000
Furniture at cost	7,000	9,000
Investment at cost	60,000	80,000
Debtors	30,000	70,000
Stock	60,000	65,000
Cash	30,000	45,000
	3,91,000	**4,69,000**
Liabilities :		
Share capital	1,00,000	1,50,000
Share premium	–	5,000
General reserve	50,000	60,000
Profit & Loss A/c	10,000	17,000
6% Debentures	70,000	50,000
Provision for depreciation on plant	50,000	56,000
Provision for depreciation on furniture	5,000	6,000
Provision for taxation	20,000	30,000
Sundry creditors	86,000	95,000
	3,91,000	**4,69,000**

A plant purchase for ₹ 4,000 (depreciation ₹ 2,000) was sold for cash ₹ 800 on 30th Sep. 1992. On 30th June 1992, an item of furniture was purchased for ₹ 2,000. These were the only transitions fixed assets during 1992. Depreciation on plant was provided at 8% on cost (the sold item is not taken into consideration) and on furniture at 12½ % on average cost. A dividend of 22½% on original shares was paid.

Prepare a schedule of changing in working capital and statement of sources and application of funds during 1992.

[**Ans.** Increase in working capital: ₹ 51,000; Total sources of funds: ₹ 1,35,500; Applications of funds: ₹ 84,500; Funds from operation: ₹ 79,700; Loss on sale of plant: ₹ 1,200; Depreciation of plant for 1992; ₹ 8,000; Opening Balance of provision for tax is to be assumed as paid i.e., ₹ 20,000; Closing balance of ₹ 30,000 is the provision for 1992; Dividend ₹ 22,5000]

Notes

Unit–6

Cash Flow Statement

Notes

Structure

5.1. How to Adjust for Non-Cash Transactions

In business accounting, non-cash transactions include any items that do not directly involve the transfer of money. When preparing a cash-flow statement, the only way to adjust fro non-cash transactions is through the indirect method, which subtracts rule items from the company's net income. For longer businesses that often deal with non-cash transactions, preparing a cash-flow statement using the indirect method is important as it gives a more accurate description of the company's current finances.

Cash-Flow Statements

A cash-flow statement is a document prepared by a company that details how much money is flowing in and out of the business. Specifically, it shows the change in cash and cash equivalents in a given period of time. Along with a income statement, most small businesses prepare a cash-flow statement, most small businesses prepare a cash-flow statement at least every quarter. Some may even prepare one every month. While a cash-flow statement is a requirement for publicly listed companies, non-listed companies still use them for keeping track of payments. Many hire an accountant familiar with GAAP accounting rules and standard to prepare a cash-flow statement.

Non-Cash Transactions

On a cash-flow statement, a non-cash transaction encompasses any aspect that undergoes depreciation or amortization. This included transactions such as the conversion of bonds to other types of assets or vice versa, lease arrangements that lead to a purchase, such as commercial real estate rentals, and the exchange of any asset for another asset that is not cash. Items such as interest rate payments are non-cash transactions. Although non-cash transactions do not normally appear on a cash-flow statement, an accountant can adjust a cash-flow statement to factor in such transactions. To do this, an accountant uses the indirect method of creating a cash-flow statement.

The Indirect Method of Cash-Flow Statement Preparation

Notes

There are two main methods for constructing a cash-flow statement: the direct and indirect method. The former simply sums up all cash transactions, from both customers and investment activities and adds and subtracts any interest or dividends the company is liable for. The accountant, using this information, then computes the cash flow for the company for the end of the year. The indirect method, on the other hand, computes the end of year cash flow by adding up net income and rule items. The accountant obtains net income from the company's income statement. Rule items include all non-cash transactions.

Example

Consider a company with a net income of $ 100,000 a year. The accountant adjusts net income upward for the following non-cash transactions: $ 2,000 for depreciation, $₹ 1,000 for the amortization of bond discount, $ 1,000 for the loss on sale of equipment, $ 1,000 for the decreases in account receivable and ₹ 1000 to ₹ 1,06,000. The accountant then adjust net income downward premium. ₹ 200 for gain on the sale of –

5.2. Introduction

Cash contributes significant role in the entire economic activities of the business world. And at the same time, cash is not only essential for business, but is also essential for each and every activity of human life. What blood is to human body, cash is to a business firm. The firm receives cash from various sources like issue of shares, sale of assets etc. It needs cash to make payments for various purposes like payment to suppliers and to meet out the day to day expenses. The foremost responsibility of the financial manager is to determine cash planning activities and to maintain adequate cash balances. At this juncture cash flow statement is an important tool of cash planning and control. The term cash is used to refer to cash in hand and bank balance.

5.3. Meaning

Cash flow statement is a statement which is prepared from the historical data showing the inflow and outflow of cash. It shows the sources and uses of cash between the two balance sheet dates. It clearly explains the causes for changes in cash position between two periods. Simply, it is a receipts and payments account in a summary form.

5.4. Uses of Cash Flow Statement

Cash flow statement is an important tool of financial analysis. It is vital to financial management. Its main uses are as follows :

Notes

(*i*) It gives guidance to the management in taking and implementing short-term financial policies.

(*ii*) It helps to strengthen the borrowing capacities of the firms. The financial institutions can easily assess the repaying capacities of the firms through the cash flow analysis.

(*iii*) It contributes significant role for the capital budgeting decisions.

(*iv*) It helps in short term financial decisions relating to liquidity.

(*v*) In order to find out the variation and take necessary remedial measures with the help of the comparison of actual cash flow statements with the projected cash flow statements.

(*vi*) To overcome the problem of meeting deficit cash or investment of surplus cash with the help of the projected cash flow statement. Thus, projected cash flow statement is usually prepared on the basis of past year's experience.

(*vii*) It explains the causes for poor cash position in spite of huge profits or surplus cash balance in spite of low profits.

(*viii*) It explains the major sources and uses of cash for the business concern during a particular period of time.

5.5. Limitations of Cash Flow Analysis

Cash flow statement is a systematic tool of financial analysis. However, it suffers from some limitations which are as follows :

1. A cash flow statement cannot be equated with the income statement. An income statement considers both cash and non-cash items. So, cash does not mean net income of business.
2. The cash flow statement may not represent the real liquid position of the concern. Due to this aspect, postponing of purchases and payments could be developed.
3. Cash flow statement cannot replace the income statement or fund flow statement. Each and every statement has a separate function to perform.
4. Due to inflation, economic depression and other external factors, projected cash flow statement may not achieve its results.

5.6. Difference Between Cash Flow Analysis and Fund Flow Analysis

1. Cash flow statement starts with the opening cash balance and ends with the closing cash balance by processing through various sources and uses. But, there are no opening and closing balances in fund flow statement.
2. Cash from operation can be found out under the cash flow statement. But, fund from operation can be found out under the fund flow statement.
3. Separate statements are prepared for the purpose of finding out increase or decrease in working capital under the fund flow statement. But, no separate

statements for increase or decrease in working capital are prepared in cash flow analysis.

4. A cash flow statement explains the causes for the changes in cash and bank balances i.e., cash receipts and cash payments alone. But, fund flow statement indicates the causes for the changes in net working capital.
5. Cash flow statement is suitable for short term financial planning and decision, while fund flow statement is appropriate for long term financial planning and decisions.
6. Cash flow analysis deals with the movement of actual or notional cash. But, fund flow statement deals with not only cash but also the items constituting working capital. Cash is one of the components of working capital.
7. Whenever, wherever there is inflow of cash there will definitely be inflow of funds. But, sound fund position need not be a sound cash position.

Notes

5.7. Steps in Preparation of Cash Flow Statement

Cash flow statement can be prepared on the same pattern on which fund flow statement is prepared. But, here statement of changes in working capital does not need to be prepared. Remaining all other procedures were same in fund flow statement.

Cash flow statement is prepared on any one of the following assumptions :

— When all transactions are taken as cash transactions.

— When all transactions are not cash transactions.

Here, we have to proceed with all the problems by treating all the transactions as cash transactions.

Steps

1. No need to prepare working capital statement
2. Preparation of cash flow statement
3. Preparation of profit & loss account-computation of cash from operation
4. Preparation of separate ledger if necessary
5. Treatment of adjustments

1. No need to prepare the working capital statement

Changes in current assets and current liabilities are adjusted in the cash flow statement itself. So, separate statement is not necessary for the changes in working capital.

2. Cash Flow Statement (Proforma)

Inflow of cash	Amount ₹	Outflow of cash	Amount ₹
Opening Cash Balance	xx	Redemption of preference shares	xx
(including bank balance)	xx	Repayment debenture holders	xx
Issue of Shares	xx	Repayment of Loans	xx

Notes

Issue of Debentures	xx	Purchase of fixed assets	xx
Raising of loans	xx	Dividend paid	xx
Sale of fixed assets	xx	Income Tax paid	xx
Dividends received	xx	Cash from Operation (Lost in	
Share premium received	xx	operation) Transfer from P&L	
Cash from operation	xx	A/c	xx
(Transfer from P&L A/c)	xx	Closing balance (including bank	
		balance)	
	xx		xx

3. **Preparation of Profit & Loss Account - Computation of cash from operation**

   Cash from operations can be found out in two methods. One is statement form another one is preparation of profit and loss account. Normally, cash from operation can be found out with the help of the preparation of profit and loss account because it is an easy and convenient method. Here, profit and loss account is prepared in usual procedure.

Profit and Loss A/c

Dr. **Cr.**

	Amount ₹		Amount ₹
To Goodwill written off	xx	By Opening Balance b/d	xx
To General reserve	xx	By Dividends received	xx
To Preliminary expenses	xx	By Interest on investments	xx
written off		By Profit on sale of assets	xx
To Depreciation	xx	By Cash from operation	xx
To Loss on sale of fixed assets	xx	(Balancing figure)	
To Loss on sale of Investments	xx		
To Patents & Trade mark	xx		
written off			
To Income tax provided	xx		
To Interim dividend paid	xx		
To Closing balance c/d	xx		
To Cash from operation	xx		
(Balancing figure)			
	xx		xx

4. Preparation of Separate Ledger

If information of any particular assets or liabilities are given in the adjustment, we have to prepare separate asset or liabilities account. Balances from this ledger can be transferred to cash flow statement.

5. Treatment of adjustments

The additional information which are given apart from the balance sheet are, simply called as adjustment. All the adjustments will appear in two places. The following are the important adjustments and their treatment.

(*a*) Dividend paid	–	Cash flow statement - outflow side
	–	Profit & loss A/c - Debit side
(*b*) Depreciation	–	P.L.A/c - Debit side
		Respective asset A/c - credit side
(*c*) Loss on sale of assets	–	P.L.A/c - Debit side
		Respective asset A/c - credit side
(*d*) Income Tax provision	–	P.L.A/c - Debit side
	–	Income Tax - Credit side.

Note:	The adjustments applicable for fund flow statements will also be applicable for cash flow statements.

Illustration and Solutions

***Illustration 1.** From the following profit and loss account, compute the case from operations.*

Profit and Loss account for the year ended 31.3.2001

	Amount ₹		Amount ₹
To Salaries	25,000	By Gross Profit	1,25,000
To Rent	3,000	By Profit on sale of land	15,000
To Depreciation	10,000	By Income tax refund	13,000
To Loss on Sale of plant	4,000		
To Goodwill written off	10,000		
To Proposed dividend	15,000		
To Provision for Tax	12,000		
To Net Profit	74,000		
	1,53,000		1,53,000

Solution :

Computation of cash from operation

Net profit earned during the year		74,000
Add : Non-cash and Non-operating expenses		
Depreciation	10,000	
Loss on sale of plant	4,000	

Goodwill written off	10,000	
Proposed dividend	15,000	
Provision for tax	12,000	
		51,000
		1,25,000
Less : Non-cash and Non-operating income		
Profit on sale of land	15,000	
Income tax refund	13,000	
		28,000
Cash from operation		97,000

Notes

Illustration 2. *Statement of financial position of Mr.Arun is given below.*

Liabilities	*1.1.2000* ₹	*31.12.200* ₹	*Assets*	*1.1.2000* ₹	*31.12.200* ₹
Account Payable	*29,000*	*25,000*	*Cash*	*40,000*	*30,000*
Capital	*7,39,000*	*6,15,000*	*Debtors*	*20,000*	*17,000*
			Stock	*8,000*	*13,000*
			Building	*1,00,000*	*80,000*
			Other fixed Assets	*6,00,000*	*5,00,000*
	7,68,000	*6,40,000*		*7,68,000*	*6,40,000*

The following additional information is also available:

(a) There were no drawings.

(b) There were no purchases or sale of either building or other fixed assets. Prepare a statement of case flow.

Solution : **Cash Flow Statement**

Inflow of cash	**Amount** ₹	**Outflow of cash**	**Amount** ₹
Opening cash balance	40,000	Decrease in accounts payable	4,000
Decrease in Debtors	3,000	Increase in Stock	5,000
		Cash from operation (1)	4,000
		Closing cash balance	30,000
	43,000		43,000

Workings : **1. Profit and Loss Account**

	Amount ₹		**Amount** ₹
To Depreciation on Building	20,000	By Capital Account (Loss)	1,24,000
To Depreciation on Plant	1,00,000		
To Cash from operation (Loss on operation)			
	1,24,000		1,24,000

Notes

2. Capital Account of Mr. Arun

To Profit & Loss A/c (Loss)	1,24,000	By Balance b/d	7,39,000
To Balance c/d	6,15,000		
	7,39,000		7,39,000

3. Building Account

To Balance b/d	6,00,000	By Depreciation (P&L A/c)	1,00,000
		By Balance c/d	80,000
	1,00,000		1,00,000

4. Other Fixed Assets Account

To Balance c/d	6,00,000	By Depreciation (P&L A/c)	1,00,000
		By Balance c/d	5,00,000
	6,00,000		6,00,000

Illustration 3. *From the following particulars of Mrs.Ragu, prepare cash flow statements.*

Liabilities:	**1.1.99** ₹	**31.12.99** ₹
Creditors	36,000	41,000
Mrs.A's Loan	—	20,000
Capital	1,48,000	1,49,000
Bank Loan	30,000	25,000
	2,14,000	2,35,000
Assets:		
Cash	4,000	3,600
Debtors	35,000	38,400
Stock	25,000	22,000
Land	20,000	30,000
Buildings	50,000	55,000
Machinery	80,000	86,000
	2,14,000	2,35,000

During the year Mrs.Ragu had drawn ₹ 26,000 for personal use. The provision for depreciation against machinery as on 1.1.99 was ₹ 27,000 and as on 31.12.99 ₹ 36,000.

Solution : Cash Flow Statement

Notes

Inflow of cash	Amount ₹	Outflow of cash	Amount ₹
Opening cash balance	4,000	Repayment of Bank loan	5,000
Loan borrowed from Mrs. A	20,000	Increase in Debtors	3,400
Decrease in stock	3,000	Purchase of Land	10,000
Cash from operation (1)	36,000	Purchase of Buildings	5,000
Increase in creditors	5,000	Capital Account (Drawings)	26,000
		Purchase of machinery (3)	15,000
		Closing Cash Balance	3,600
	68,000		68,000

Workings : 1. Profit and Loss Account

	Amount ₹		Amount ₹
To Depreciation (4)	9,000	By Cash from operation	36,000
To Capital Account	27,000		
	36,000		36,000

2. Capital Account

To Cash (Drawings)	26,000	By Balance b/d	1,48,000
To Balance c/d	1,49,000	By Profit & Loss A/c	27,000
		(Transfer to P&L A/c)	
	1,75,000		1,75,000

3. Machinery Account

To Balance b/d (80,000+27,000)	1,07,000	By Balance c/d (86,000+36,000)	1,22,000
To Cash (b/f)	15,000		
	1,22,000		1,22,000

4. Accumulated Depreciation Account

To Balance c/d	36,000	By Balance b/d	27,000
		By P&L A/c (b/f)	9,000
	36,000		36,000

Illustration 4. *The Balance sheet of Super Computers Ltd. as on 31.12.1992 and 31.12.1993 respectively are given below.*

Liabilities	*1992* ₹	*1993* ₹	*Assets*	*1992* ₹	*1993* ₹
Share capital	*1,00,000*	*1,60,000*	*Fixed assets at*		
Retained earnings	*70,250*	*85,300*	*cost*	*1,52,000*	*2,00,000*

Accumulated			*Inventory*	*93,400*	*89,200*
Depreciation	*60,000*	*40,000*	*Sundry Debtors*	*30,800*	*21,100*
6% Debentures	*50,000*	—	*Prepaid expenses*	*3,950*	*3,000*
Sundry creditors	*28,000*	*48,000*	*Bank*	*28,100*	*20,000*
	3,08,250	*3,33,300*		*3,08,250*	*3,33,300*

The following additional information for the year 1993 is also available.

(i) Net profit ₹ 27,050.

(ii) Depreciation charged ₹ 10,000.

(iii) Cash dividend declared during the period ₹ 12,000.

(iv) An addition to the building was made during the year at a cost of ₹ 78,000 and fully depreciated equipment costing ₹ 30,000 was discorded, no salvage value being realised. Prepare cash flow statement.

Solution : **Cash Flow Statement**

Inflow of cash	Amount ₹	Outflow of cash	Amount ₹
Opening cash balance	28,100	Redemption of debentures	50,000
Decrease in inventory	4,200	Cash dividend paid	12,000
Decrease in debtors	9,700	Purchase of building	78,000
Decrease in prepaid expenses	950	Closing cash balance	20,000
Issue of shares	60,000		
Cash from operation	37,050		
Increase in creditors	20,000		
	1,60,000		1,60,000

Workings : **1. Profit and Loss Account**

	Amount ₹		Amount ₹
To Cash dividend paid	12,000	By balance b/d	70,250
To Depreciation (Current year)	10,000	By Cash from operation (b/f)	37,050
To Balance c/d	85,300		
	1,07,300		1,07,300

2. Accumulated Depreciation Account

To Fixed Assets	30,000	By Balance b/d	60,000
(Discarded Equipment)		By P&L A/c	10,000
To Balance c/d	40,000		
	70,000		70,000

Notes

3. Accumulated Depreciation Account

To Balance b/d	1,52,000	By Depreciation	30,000
To Cash (Purchase)	78,000	By Balance c/d	2,00,000
	2,30,000		2,30,000

Illustration 5. *The following are the summarised balance sheets of South Computers Ltd. as on 31.12.2000 and 31.12.2001.*

Liabilities	*2000* ₹	*2001* ₹	*Assets*	*2000* ₹	*2001* ₹
Share Capital	*2,00,000*	*2,50,000*	*Land & Buildings*	*2,00,000*	*1,90,000*
General Reserve	*50,000*	*60,000*	*Machinery*	*1,50,000*	*1,69,000*
P&L A/c	*30,500*	*30,600*	*Stock*	*1,00,000*	*74,000*
Bank loan	*70,000*	—	*Sundry Debtors*	*80,000*	*64,200*
Sundry Creditors	*1,50,000*	*1,35,200*	*Cash*	*500*	*600*
Provision for			*Bank*	—	*8,000*
Taxation	*30,000*	*35,000*	*Goodwill*	—	*5,000*
	5,30,500	*5,10,800*		*5,30,500*	*5,10,800*

The following additional information for the the year 2001 is also available :

(*i*) *Dividend of ₹ 23,000 was paid.*

(*ii*) *The following assets of another company were purchased for a consideration of ₹ 50,000 paid in shares.*

(a) Stock ₹ 20,000 and (b) Machinery ₹ 25,000

(*iii*) *Machinery was further purchased for ₹ 8,000.*

(*iv*) *Depreciation written off machinery ₹ 12,000.*

(*v*) *Income Tax provided during the year ₹ 33,000.*

(*vi*) *Loss on sale of machinery ₹ 200 was written off to general reserve.*

(*vii*) *Prepare cash flow statement.*

Solution : **Cash Flow Statement**

Inflow of cash	**Amount** ₹	**Outflow of cash**	**Amount** ₹
Opening cash balance	500	Repayment of Bank Loan	70,000
Sale of Land & Building	10,000	Decrease in Sundry Creditors	14,800
Decrease in Sundry Debtors	15,800	Dividend paid	23,000
Sale of Machinery	1,800	Purchase of Machinery	8,000
Sale of Stock	46,000	Income Tax paid	28,000
Cash from operation	78,300	Closing cash balance (8,000 + 600)	8,600
	1,52,400		1,52,400

Notes

Workings :

1. Share Capital Account

	Amount ₹		Amount ₹
To Balance c/d	2,50,000	By Balance b/d	2,00,000
		By Stock	20,000
		By Machinery	25,000
		By Goodwill	5,000
	2,50,000		2,50,000

2. General Reserve Account

To Loss on sale of Machinery	200	By Balance b/d	50,000
To Balance c/d	60,000	By Profit & Loss A/c	10,200
	60,200		60,200

3. Provision for Taxation Account

To Cash (Tax paid)	28,000	By Balance b/d	30,000
To Balance c/d	35,000	By P & L A/c	33,000
	63,000		63,000

4. Profit and Loss Account

To Dividend Paid	23,000	By Balance b/d	30,500
To Depreciation on Machinery	12,000	By Cash from operation	78,300
To Income tax provided	33,000		
To Transfer to General Reserve	10,200		
To Balance c/d	30,600		
	1,08,800		1,08,800

5. Machinery Account

To Balance b/d	1,50,000	By Depreciation	12,000
To Shares	25,000	By Loss on sale of Machinery	200
To Cash	8,000	By Cash (b/f)	1,800
		By Balance c/d	1,69,000
	1,83,000		1,83,000

6. Stock Account

To Balance b/d	1,00,000	By Cash (b/f)	46,000
To Shares	20,000	By Balance c/d	74,000
	1,20,000		1,20,000

7. Goodwill Account

To Balance b/d	Nil	By Balance c/d	5,000
To Shares	5,000		
	5,000		5,000

Notes

Note: In the absence of direction, the differences in the Land & Building value (i.e., 2,00,000 − 1,90,000 = 10,000) are treated as sale of Land & Building and not as depreciation. If any specific direction is given in the problem, we proceed with the problem according to the direction.

Illustration 6. *Balance Sheets of M/s.Black and White as on 1st Jan.2000 and 31st Dec. 2000 were as follows.*

Liabilities	*Jan.2000* ₹	*Dec.2000* ₹	*Assets*	*Jan.2000* ₹	*Dec.2000* ₹
Creditors	*40,000*	*44,000*	*Cash*	*10,000*	*7,000*
White loan	*25,000*	—	*Debtors*	*30,000*	*50,000*
Loan from bank	*40,000*	*50,000*	*Stock*	*35,000*	*25,000*
Capital	*1,25,000*	*1,53,000*	*Land*	*40,000*	*50,000*
			Building	*35,000*	*60,000*
			Machinery	*80,000*	*55,000*
	2,30,000	*2,47,000*		*2,30,000*	*2,47,000*

During the year machine costing ₹ 10,000 (accumulated depreciation ₹ 3,000) was sold for ₹ 5,000. The provision for depreciation against machinery as on 1st Jan. 2000 was ₹ 25,000 and on 31st Dec. 2000 ₹ 40,000. Net profit for the year 2000 amounted to ₹ 45,000. Prepare cash flow statement.

Solution : **Cash Flow Statement**

Inflow of cash	**Amount** ₹	**Outflow of cash**	**Amount** ₹
Opening cash balance	10,000	Increase in Debtors	20,000
Decrease in stock	10,000	Purchase of Land	10,000
Increase in Creditors	4,000	Purchase of Buildings	25,000
Loan from Bank	10,000	Repayment of Mr. White's Loan	25,000
Cash from Operation (1)	65,000	Capital Account (3) (Drawings)	17,000
		Closing Cash Balance	7,000
	1,04,000		1,04,000

Notes

Workings :

1. Profit and Loss Account

	Amount ₹		Amount ₹
To Loss on sale of Machinery	2,000	By Balance b/d	Nil
To Depreciation (4)	18,000	By Cash from operation	65,000
To Balance c/d	45,000		
	65,000		65,000

2. Machinery Account

To Balance b/d (80,000 + 25,000)	1,05,000	By Cash	5,000
		By P&L A/c	2,000
		By Accumulated Depreciation	3,000
		By Balance c/d (55,000 + 40,000)	95,000
	1,05,000		1,05,000

3. Capital Account

To Cash	17,000	By Balance b/d	1,25,000
To Balance c/d	1,53,000	By P&L A/c	45,000
	1,70,000		1,70,000

4. Accumulated Depreciation Account

To Machinery A/c	3,000	By Balance b/d	25,000
To Balance c/d	40,000	By P&L A/c	18,000
	43,000		43,000

Illustration 7. *From the following balance sheet of Exe Ltd., prepare cash flow statement.*

Liabilities	*1.1.99* ₹	*31.12.99* ₹
Equity share capital	*3,00,000*	*4,00,000*
Redeemable preference		
Share capital	*1,50,000*	*1,00,000*
General Reserve	*40,000*	*70,000*
Profit & Loss A/c	*30,000*	*48,000*
Proposed dividend	*42,000*	*50,000*
Creditors	*55,000*	*83,000*
Bills Payable	*20,000*	*16,000*
Provision for taxation	*40,000*	*50,000*
	6,77,000	*8,17,000*

Notes

Assets		
Goodwill	*1,15,000*	*90,000*
Land & Buildings	*2,00,000*	*1,70,000*
Plant	*80,000*	*2,00,000*
Debtors	*1,60,000*	*2,00,000*
Stock	*77,000*	*1,09,000*
Bills Receivable	*20,000*	*30,000*
Cash in hand	*15,000*	*10,000*
Cash at bank	*10,000*	*8,000*
	6,77,000	*8,17,000*

The following additional information is also available :

(*a*) Depreciation of ₹ 10,000 and ₹ 20,000 have been charged on Plant and Land and Buildings in 2000.

(*b*) A dividend of ₹ 20,000 has been paid in 2000.

(*c*) Income tax of ₹ 35,000 has been paid during 2000.

Solution : **Cash Flow Statement**

Inflow of cash	Amount ₹	Outflow of cash	Amount ₹
Opening Cash Balance	25,000	Redemption of preference Shares	50,000
Issue of Shares	1,00,000	Dividend paid	42,000
Increase in Sundry Creditors	28,000	Decrease in Bills Payable	4,000
Sale of Land & building	10,000	Increase in Debtors	40,000
Cash from operation	2,18,000	Increase in Stock	32,000
		Increase in bills receivable	10,000
		Purchase of Plant	1,30,000
		Interim dividend paid	20,000
		Income Tax paid	35,000
		Closing Cash balance (10,000 + 8,000)	18,000
	3,81,000		3,81,000

Workings: **1. Profit and Loss Account**

	Amount ₹		Amount ₹
To General Reserve	30,000	By Balance c/d	30,000
To Proposed dividend	50,000	By Cash from operation	2,18,000
To Goodwill written off	25,000		

To Depreciation of Plant	10.000		
To Depreciation of Land & Buildings	20.000		
To Interim dividend paid	20.000		
To Income Tax provided (2)	45,000		
To Balance c/d	48.000		
	2.48.000		2,48,000

Notes

2. Provision for Taxation Account

To Cash (Tax paid)	35.000	By Balance b/d	40.000
To Balance c/d	50.000	By P&L A/c	45.000
	85,000	(Tax Provisions)	85,000

3. Land & Buildings Account

To Balance b/d	2.00.000	By Depreciation A/c	20,000
		By Balance c/d	1,70.000
		By Cash (b/f)	10.000
	2,00,000		2,00.000

4. Plant Account

To Balance b/d	80.000	By Depreciation	10,000
To Cash (b/f)	1.30.000	By Balance c/d	2,00,000
	2,10,000		2,10,000

Illustration 8. *From the following comparative Balance Sheet of ABC Ltd. as on 31.12.2002 and 2002.*

Liabilities	2001 ₹	2002 ₹	Assets	2001 ₹	2002 ₹
Share Capital	70,000	74,000	Cash	9,000	7,800
Debentures	12,000	6,000	Trade Debtors	14,900	17,700
Creditors	10,360	11,840	Marketable Securities	49,200	42,700
Provision for Doubtful debts	700	800	Land	20,000	30,000
Profit & Loss A/c	10,040	10,560	Goodwill	10,000	5,000
	1,03,100	1,03,200		1,03,100	1,03,200

The following additional information is also available :

(i) Dividend of ₹ 3,500 was paid during the year 2002.

(ii) Land was purchased for ₹ 10,000 and amount provided for the amortization of goodwill of ₹ 5,000.

(iii) Debentures was repaid ₹ 6,000.

Prepare cash flow statement.

Notes

Solution : **Cash Flow Statement**

Inflow of cash	Amount ₹	Outflow of cash	Amount ₹
Opening cash balance	9,000	Increase in Debtors	2,800
Issue of Shares	4,000	Dividend paid	3,500
Increase in Creditors	1,480	Purchase of land	10,000
Decrease in Marketable Securities	6,500	Redemption of debentures	6,000
Cash from Operation	9,120	Closing cash balance	7,800
	30,100		30,100

Workings : **1. Profit and Loss Account**

	Amount ₹		Amount ₹
To Provision for Doubtful debts	100	By Balance b/d	10,040
To Dividend Paid	3,500	By Cash from operation	9,120
To Goodwill written off	5,000		
To Balance c/d	10,560		
	19,160		19,160

2. Debentures Account

To Cash (b/f)	6,000	By Balance b/d	12,000
To Balance c/d	6,000		
	12,000		12,000

3. Land Account

To Balance b/d	20,000	By Balance c/d	30,000
To Cash	10,000	By Balance c/d	5,000
	30,000		30,000

4. Goodwill Account

To Balance b/d	10,000	By P&L A/c	5,000
		By Balance c/d	5,000
	10,000		10,000

Illustration 9. *From the following Balance Sheet of Gristol Ltd., make out the statement of sources and uses of case.*

Liabilities	*1998* ₹	*1999* ₹	*Assets*	*1998* ₹	*1999* ₹
Capital	*1,15,000*	*1,15,000*	*Cash & Bank*		
Sundry Creditors	*51,500*	*48,000*	*Balance*	*45,000*	*45,000*
Outstanding Expn.	*6,500*	*6,000*	*Sundry Debtors*	*33,500*	*21,500*

Notes

8% Debentures	*45,000*	*35,000*	*Temporary*		
Depreciation Fund	*20,000*	*22,000*	*Investment*	*55,000*	*37,000*
Reserve for			*Prepaid Expenses*	*500*	*1,000*
Contingencies	*30,000*	*30,000*	*Stock in Trade*	*41,000*	*53,000*
Profit & Loss A/c	*8,000*	*11,500*	*Land & Buildings*	*75,000*	*75,000*
			Machinery	*26,000*	*35,000*
	2,76,000	*2,67,500*		*2,76,000*	*2,67,500*

The following additional information is also available :

(*i*) 10% dividend was paid in cash.

(*ii*) New machinery for ₹ 15,000 was purchased but old machinery costing ₹ 6,000 was sold for ₹ 2,000; accumulated depreciation was ₹ 3,000.

(*iii*) ₹ 10,000 8% debentures were redeemed by purchase from open market @ ₹ 96 for a debenture of ₹ 100.

(*iv*) ₹ 18,000 investments were sold at book value.

Solution : **Cash Flow Statement**

Inflow of cash	Amount ₹	Outflow of cash	Amount ₹
Opening Cash balance	45,000	Decrease in Sundry Creditors	3,500
Decrease in Sundry debtors	12,000	Decrease in Outstanding	
Sale of Machinery	2,000	Expenses	500
Sale of Investments	18,000	Increase in prepaid expenses	500
Cash from operation	20,600	Redemption of debentures	9,600
		Increase in Stock in Trade	12,000
		Payment of dividend	11,500
		Purchase of Machinery	15,000
		Closing Stock balance	45,000
	97,600		97,600

Workings : **1. Profit and Loss Account**

	Amount ₹		Amount ₹
To Payment of dividend	11,500	By Balance b/d	8,000
To Loss on sale of Machinery	1,000	By Profit on Redemption of	
To Depreciation	5,000	Debentures	
To Balance c/d	11,500	(10,000-9,600)	400
		By Cash from operation	20,600
	29,000		29,000

Notes

2. Accumulated Depreciation Account

To Machinery	22,000	By Balance b/d	20,000
To Balance c/d	3,000	By P&L A/c (b/f)	5,000
	25,000		25,000

3. Machinery Account

To Balance b/d	26,000	By Cash	2,000
To Cash (b/f)	15,000	By P&L A/c	1,000
		By Accumulated Depreciation	3,000
		By Balance c/d	35,000
	41,000		41,000

4. Debenture Account

To Cash	9,600	By Balance b/d	45,000
To Profit on Redemption	400		
To Balance c/d	35,000		
	45,000		45,000

5. Investment Account

To Balance b/d	55,000	By Cash	18,000
		By Balance c/d	37,000
	55,000		55,000

Note: Redemption of debenture $\frac{96}{100} \times 10,000 = 9,600$

Actual value of debenture	=	10,000
Amount paid	=	9,600
Profit on Redemption of debenture	=	400

Illustration 10. *The Comparative Balance Sheets of Mr. Hitler for the two years are as follows.*

Liabilities	*2002* ₹	*2003* ₹	*Assets*	*2002* ₹	*2003* ₹
Loan from wife	—	*20,000*	*Cash*	*11,000*	*15,000*
Bills Payable	*12,000*	*8,000*	*Debtors*	*40,000*	*35,000*
Creditors	*25,000*	*52,000*	*Stock*	*25,000*	*30,000*
Loan from Bank	*43,000*	*60,000*	*Machinery*	*20,000*	*14,000*
Capital	*66,000*	*34,000*	*Land & Buildings*	*50,000*	*80,000*
	1,46,000	*1,74,000*		*1,46,000*	*1,74,000*

The following additional information is also available :

(i) Net Loss for the year 2003 amounted to ₹ 13,000.

(ii) *During the year machine costing ₹ 5,000 (accumulated depreciation ₹ 2,000) was sold for ₹ 2,500. The provision for depreciation against machinery as on 31.12.2002 was ₹ 6,000 and on 31.12.2003 was ₹ 7,000.*

Notes

Solution : **Cash Flow Statement**

Inflow of cash	Amount ₹	Outflow of cash	Amount ₹
Opening cash balance	11.000	Decrease in bills payable	4,000
Loan borrowed from wife	20,000	Increase in Stock	5,000
Increase in Creditors	27,000	Purchase of Land & Buildings	30,000
Loan borrowed from bank	17,000	Drawings (2) (Capital A/c)	19,000
Decrease in Debtors	5,000	Cash from operation	9,500
Sale of Machinery	2,500	Closing cash balance	15,000
	82,500		82,500

Workings : **1. Profit and Loss Account**

	Amount ₹		Amount ₹
To Loss on sale of Machinery	500	By Balance b/d	13,000
To Depreciation A/c	3,000		
To Cash from operation	9,500		
	13,000		13,000

2. Capital Account

To Profit & Loss A/c (Net Loss)	13,000	By Balance b/d	66,000
To Balance c/d	34,000	By Profit & Loss A/c	500
To Cash (b/f)	19,000		
	66,000		66,000

3. Machinery Account

To Balance b/d (20,000 + 6,000)	26,000	By Cash	2,500
		By Profit & Loss A/c	500
		By Accumulated Deprecation	2,000
		By Balance c/d (14,000 + 7,000)	21,000
	26,000		26,000

4. Accumulated Depreciation Account

To Machinery A/c	2,000	By Balance b/d	6,000
To Balance c/d	7,000	By P&L A/c	3,000
	9,000		9,000

Notes

Note:	Journal Entry for IInd Adjustment				
	Cash A/c	Dr.	2,500		(Sale price)
	Accumulated Depreciation A/c	Dr.	2,500		(Depreciation)
	Profit & Loss A/c	Dr.	500		(Loss)
	To Machinery			5,000	(Value of machinery)

Illustration 11. From the comparative balance sheets of Serial Engineering Ltd. As at 31.12.1998 and other information furnished, prepare a cash flow statement for the year ended on 31.12.1998.

Liabilities	*1997* ₹	*1998* ₹	*Assets*	*1997* ₹	*1998* ₹
Equity Share			*Fixed Assets*	*2,40,000*	*4,20,000*
Capital	*50,000*	*2,00,000*	*Investments*	*18,000*	*15,000*
Redeemable Pref.			*Stock*	*58,500*	*1,60,000*
Share Capital	*1,00,000*	—	*Sundry Debtors*	*1,37,000*	*92,000*
Retained Earning	*1,20,000*	*3,50,000*	*Cash at Bank*	*1,85,000*	*1,20,000*
Unsecured Loan	*1,25,000*	—	*Prepaid expenses*	*6,500*	*8,000*
Bills payable	*2,25,000*	*1,90,000*			
Provision for Tax	*25,000*	*75,000*			
	6,45,000	*8,15,000*		*6,45,000*	*8,15,000*

The following additional information is also available :

(i) *On 31.12.1998 accumulated depreciation on fixed assets amounted to ₹ 1,20,000 and on 31st December 1997 to ₹ 1,10,000.*

(ii) *Machinery costing ₹ 10,000 (Accumulated depreciation thereon being ₹ 5,000) was discarded and written off during 1998.*

(iii) *Depreciation written off during 1998 amounted to ₹ 15,000.*

(iv) *During the year 1998 investments costing ₹ 6,000 were sold for ₹ 7,000.*

(v) *Dividend paid during the year was ₹ 45,000.*

(vi) *Redeemable preference shares were redeemed out of profile during the year at a premium of 5%.*

Solution : **Cash Flow Statement**

Inflow of cash	Amount ₹	Outflow of cash	Amount ₹
Opening Cash Balance	1,85,000	Repayment unsecured loan	1,25,000
Issue of Shares	1,50,000	Decrease in bills payable	35,000
Increase in provision for taxation	50,000	Increase in stock	1,01,500
Decrease in Sundry Debtors	45,000	Increase in prepaid expenses	1,500
		Dividend paid	45,000
Sale of Investments	7,000	Purchase of fixed assets (3)	2,00,000
Cash from operation	2,99,000	Redemption of preference	

		Shares	1,05,000
		Purchase of investment (4)	3,000
		Closing Cash balance	1,20,000
	7,36,000		7,36,000

Notes

Workings : **1. Profit and Loss Account**

	Amount ₹		Amount ₹
To Loss on Machinery (Discarded)	5,000	By Balance b/d	1,20,000
		By Profit on sale of Investment	1,000
To Dividend paid	45,000	By Cash from Operation	2,99,000
To Premium on Redemption of Preference shares	5,000		
To Depreciation	15,000		
To Balance c/d	3,50,000		
	4,20,000		4,20,000

2. Redeemable Preference Share Capital Account

To Cash	1,05,000	By Balance b/d	1,00,000
		By Premium	5,000
	1,05,000		1,05,000

3. Fixed Assets Account (Machinery)

To Balance b/d	3,50,000	By Profit & Loss A/c	5,000
To Cash	2,00,000	By Accumulated Depreciation	5,000
		By Balance c/d (4,20,000 + 1,20,000)	5,40,000
	5,50,000		5,50,000

4. Investment Account

To Balance b/d	18,000	By Cash	6,000
To Cash	3,000	By Balance c/d	15,000
	21,000		21,000

5. Accumulated Depreciation Account

To Balance c/d	1,20,000	By Balance b/d	1,10,000
To Machinery	5,000	By P&L A/c	15,000
	1,25,000		1,25,000

Notes

Note:	Journal Entry for Adjustment (*ii* & *iv*)			
	(*ii*) Profit & Loss A/c	Dr.	5,000	
	Accumulated Depreciation A/c	Dr.	5,000	
	To Machinery A/c			10,000
	(*iv*) Cash A/c	Dr.	7,000	
	To Profit & Loss A/c			1,000
	To Investment A/c			6,000

Illustration 12. *Prepare a cash flow statement from the balance sheets of TTD & Co. as on 31.3.2000 and 31.3.2001. (₹ in thousand)*

Liabilities	*2000* ₹	*2001* ₹	*Assets*	*2000* ₹	*2001* ₹
Capital	*140*	*140*	*Fixed Assets (Net)*	*90*	*87*
Reserve	*74*	*105*	*Cash*	*75*	*97*
Creditors	*32*	*35*	*Debtors*	*43*	*40*
Outstanding			*Inventory*	*49*	*58*
Wages	*3*	*4*	*Prepaid Expenses*	*3*	*5*
Expenses					
Outstanding	*11*	*3*			
	260	*287*		*260*	*287*

Accumulated depreciation was ₹ 16,000 and ₹ 19,000 respectively at the beginning and end of the year 2001.

Other information Sales ₹ 3,00,000, Wages ₹ 23,000. Operating Expenses ₹ 47,000, Cost of goods ₹ 1,90,000, Rent ₹ 6,000 and Depreciation ₹ 3,000.

Solution : **Cash Flow Statement**

Inflow of cash	**Amount** ₹	**Outflow of cash**	**Amount** ₹
Opening cash balance	75,000	Increase in inventory	9,000
Increase in creditors	3,000	Decrease in Miscellaneous	
Increase in wages outstanding	1,000	Expenses outstanding	8,000
Decrease on debtors	3,000	Increase in prepaid expenses	2,000
Cash from operation (1)	34,000	Closing cash balance	97,000
	1,16,000		1,16,000

Workings : **1. Profit and Loss Account**

	Amount ₹		**Amount** ₹
To Depreciation	3,000	By Balance b/d	74,000
To Balance c/d	1,05,000	By Cash operation	34,000
	1,08,000		1,08,000

2. Fixed Assets Account

To Balance b/d (90,000 + 16,000)	1,06,000	By Balance c/d (87,000 + 19,000)	1,06,000
	1,06,000		1,06,000

Notes

4. Accumulated Depreciation Account

To Balance b/d	19,000	By Balance b/d	16,000
		By P&L A/c	3,000
		(Current year Depreciation)	
	19,000		19,000

Illustration 13. *Kapin Ltd. furnishes you the following balance sheet for the year ending on 31.12.2002 and 2003. You are required to prepare cash flow statement of the year ended on 31.12.2003.*

Liabilities	*2002* ₹	*2003* ₹	*Assets*	*2002* ₹	*2003* ₹
Equity Share Capital	*10,000*	*10,000*	*Goodwill*	*1,200*	*1,200*
General Reserve	*1,400*	*1,800*	*Land*	*4,000*	*3,600*
Profit & Loss A/c	*1,600*	*1,300*	*Building*	*3,700*	*3,600*
Sundry Creditors	*800*	*540*	*Equipment*	*1,000*	*1,100*
Bills payable	*120*	*80*	*Stock*	*3,000*	*2,340*
Provision for Taxation	*1,600*	*1,800*	*Accounts Receivable*	*2,000*	*2,220*
Provision for Bad Debts	*40*	*60*	*Bank Balance*	*660*	*1,520*
	15,560	*15,580*		*15,560*	*15,580*

The following additional information is also available :

(*i*) *A piece of land has also been sold for ₹ 800.*

(*ii*) *Depreciation amounting to ₹ 600 has been charged on building.*

(*iii*) *Provision for taxation has been made for ₹ 1,700 during the year.*

Solution : **Cash Flow Statement**

Inflow of cash	**Amount** ₹	**Outflow of cash**	**Amount** ₹
Opening Cash balance	660	Decrease in Sundry Creditors	260
Decrease in stock	660	Decrease in Bills payable	40
Sale of land	800	Purchase of equipment	100
Cash from operation	2,420	Increase in account receivables	220
		Tax paid	1,500
		Purchase of building	500
		Land purchased	400
		Closing Cash balance	1,520
	4,540		4,540

Notes

Workings : **1. Profit and Loss Account**

	Amount ₹		Amount ₹
To General Reserve	400	By Balance b/d	1,600
To Provision for Doubtful debts	20	By Cash from Operation	2,420
To Depreciation on Building	600		
To Income Tax Provision	1,700		
To Balance c/d	1,300		
	4,020		4,020

2. Provision for Taxation Account

To Cash (Tax paid)	1,500	By Balance b/d	1,600
To Balance c/d	1,800	By Profit & Loss A/c (Income Tax provision)	1,700
	3,300		3,300

3. Land Account

To Balance b/d	4,000	By Cash	800
To Cash	400	By Balance c/d	3,600
	4,400		4,400

4. Building Account

To Balance b/d	3,700	By Depreciation (P&L A/c)	600
To Cash	500	By Balance c/d	3,600
	4,200		4,200

Cash Flow (AS 3) Revised Format

Under the revised format, cash flow statement should be prepared in such a way as to report the cash flows during the periods separately for operating, investing and financing activities.

I Cash Flows from Operating Activities

Net profit earned during the year	xx
Add : Depreciation	xx
Loss on sale of machinery	xx
Preliminary expenses written off	xx
Goodwill written off	xx
Patents and copy right written off	xx
Operating profit before working capital changes	xx
Adjustment of working capital	
(Add cash flow, less cash outflows)	
Decrease in current assets	xx

Decrease in current liabilities	xx	
Increase in current assets	xx	
Increase in current liabilities	xx	
Cash flows from operating activities	xx	xx

Notes

II Cash Flows from Investing Activities

Purchase of machinery	xx	
Purchase of land & building	xx	
Purchase of goodwill	xx	
Purchase of furniture	xx	
Sale of machinery	xx	
Sale of land & building	xx	
Sale of furniture	xx	
Interest on investment received	xx	
Cash flows from investing activities		xx

III Cash Flows from Financing Activities

Issue shares	xx	
Issue debentures	xx	
Loan borrowed	xx	
Redemption of shares	xx	
Redemption of debentures	xx	
Loan repaid	xx	
Dividend paid	xx	
Interim dividend paid	xx	
Drawings	xx	
Net cash flows from financing activities		xx
Net increase or decrease in cash and cash equivalent		xx
Add : Opening cash balance		
(Adjust BOD if any given the problem)		xx
Closing cash Balance		xx
(Adjust BOD if any given the problem)		

Note: In the question will specifically mention for the applying revised methods only, we follow the revised format otherwise better to follow Existing format.

Illustration 14. *Prepare cash flow statement under Revised format from the following balance sheets of Tiruchengodu Traders Ltd.*

Liabilities	*2000* ₹	*2001* ₹	*Assets*	*2000* ₹	*2001* ₹
Share Capital	*17,00,000*	*18,35,000*	*Buildings*	*8,00,000*	*10,00,000*
Reserves	*40,000*	*83,700*	*Plant and Machinery*	*2,50,000*	*3,70,000*
P & L.A/P.P. A/c	*1,00,000*	*1,30,000*	*Furniture*	*5,000*	*6,000*

Notes

Provision for dividends	*70,000*	*50,000*	*Cash*	*2,000*	*2,200*
Creditors	*1,00,000*	*95,000*	*Debtors*	*1,00,000*	*45,000*
Bank overdraft	*8,000*	*18,000*	*Bills receivable*	*8,000*	*9,000*
Bills payable	*14,000*	*13,000*	*Stock*	*4,00,000*	*3,43,700*
Mortgage Loan	*10,000*	*70,000*	*Prepaid expenses*	*3,000*	*3,100*
			Investments	*1,64,000*	*1,70,000*
			Goodwill	*3,00,000*	*3,43,700*
			Preliminary Expenses	*10,000*	*2,000*
	20,42,000	*22,94,700*		*20,42,000*	*22,94,700*

The following additional information is also available:

(a) *Depreciation is charged on buildings at 3% of cost of ₹ 9,00,000 on plant and machinery at 8% of cost of ₹ 4,00,000; Furniture at 5% of cost ₹ 8,000.*

(b) *Investments were purchased and interest was received ₹ 3,000 which was used in writing down the book value of investment.*

(c) *The declared dividends for 70,000 were paid and interim dividend for ₹ 20,000 was paid out of P & L App. A/c.*

Solution : Cash Flow Statement (Revised Method)

I Cash Flows from Operating Activities	₹	₹
Net profit before tax and extraordinary item	1,43,700	
Adjustment for depreciation for furniture	400	
Adjustment for depreciation for plant and machinery	32,000	
Adjustment for depreciation on building	27,000	
Preliminary expenses written off	8,000	
Operating profit before working capital changes	2,11,000	
Decrease in debtors	55,000	
Decrease in stock	56,300	
Decrease in creditors	(5,000)	
Increase in bills receivable	(1,000)	
Decrease in bills payable	(1,000)	
Increase in prepaid expenses	(100)	
Net cash flow from invsting activities		3,15,300
II Cash Flows from Investing Activities		
Interest on investments	3,000	
Purchase of investment	(9,000)	
Purchase of building	(2,27,000)	
Purchase of machinery	(1,52,000)	
Purchase of furniture	(1,400)	
Purchase of goodwill	(43,700)	
Net cash flow from investing activities		4,30,100

III Cash Flows from Financing Activities

Issue of shares	1,35,000	
Mortgage loan	60,000	
Dividend paid for 2000	(70,000)	
Interim dividend paid	(20,000)	
Net cash flows from financing activities		1,05,000
Net increase (decrease) in cash and cash equivalents		(9,800)
Cash and cash equivalents opening balance		
(Bank O/D-cash)		(6,000)
Cash and cash equivalents closing balance		
(Bank O/D-cash)		(15,800)

Notes

Workings : **1. Profit and Loss Account**

	Amount ₹		Amount ₹
To Balance c/d	1,30,000	By Balance b/d	1,00,000
To Transfer reserves	43,700		
To Provision for dividend	50,000	By	1,43,700
To Interim dividend paid	20,000		
	2,43,700		2,43,700

2. Building Account

To Balance b/d	8,00,000	By Balance c/d	10,00,000
To Purchase (Bf)	2,27,000	By Depreciation	
		(9,00,000 × 3/100)	
	10,27,000		10,27,000

3. Plant & Machinery A/c

To Balance b/d	2,50,000	By Balance c/d	3,70,000
To Purchase (Bf)	1,52,000	By Depreciation	
		(9,00,000 × 8/100)	32,000
	4,02,000		4,02,000

4. Furniture Account

To Balance b/d	5,000	By Balance c/d	6,000
To Purchase (Bf)	1,400	By Depreciation	
		(8,000 × 5/100)	400
	6,400		6,400

4. Investment Account

To Balance b/d	1,64,000	By Balance c/d	1,70,000
To Purchase Investment (Bf)	9,000	By Bank (Interest)	3,000
	1,73,000		1,73,000

5.8. Review Exercise

Notes

1. What is meant by cash flow statement ?
2. How will you prepare the cash flow statement ?
3. What is the purpose of preparing cash flow statement ?
4. What are the differences between cash flow and fund flow statement ?
5. Explain the advantages of cash flow statement.
6. What are the limitations of cash flow statement ?
7. From the following Balance Sheet of Arvind Ltd., you are required to prepare a cash flow statement:

Liabilities	1989 ₹	1990 ₹	Assets	1989 ₹	1990 ₹
Share Capital	4,00,000	5,00,000	Cash	60,000	94,000
Trade Creditors	1,40,000	90,000	Debtors	2,40,000	2,30,000
Profit & Loss A/c	20,000	46,000	Stock	1,60,000	1,80,000
			Land	1,00,000	1,32,000
	5,60,000	**6,36,000**		**5,60,000**	**6,36,000**

2. From the following Balance Sheet as on 31.12.93 and 31.12.92, prepare a Cash Flow Statement:

Liabilities	1993 ₹	1992 ₹	Assets	1993 ₹	1992 ₹
Share Capital	1,50,000	1,00,000	Fixed assets	1,50,000	1,00,000
Profit & Loss A/c	80,000	50,000	Goodwill	40,000	50,000
General Reserve	40,000	30,000	Stock	80,000	30,000
6% Debentures	60,000	50,000	Debtors	80,000	50,000
Creditors	40,000	30,000	Bills Receivable	20,000	30,000
Outstanding exp.	15,000	10,000	Bank	15,000	10,000
	3,85,000	**2,70,000**		**3,85,000**	**2,70,000**

3. The summarized Balance Sheet of Kandan Ltd., as on 31.12.91 and 31.12.92 are as following:

Liabilities	1991 ₹	1992 ₹	Assets	1991 ₹	1992 ₹
Share Capital	4,50,000	4,50,000	Fixed assets	4,00,000	3,20,000
General reserve	3,00,000	3,10,000	Investment	50,000	60,000
P&L A/c	56,000	68,000	Stock	2,40,000	2,10,000
Creditors	1,68,000	1,34,000	Debtors	2,10,000	4,55,000
Tax provision	75,000	10,000	Bank	1,49,000	1,97,000
Mortgage loan	-	2,70,000			
	10,49,000	**12,42,000**		**10,49,000**	**12,42,000**

Additional Details

1. Investment costing ₹ 8,000 were sold for ₹ 8,500.
2. Tax provision made the year was ₹ 9,000.
3. During the year part of the fixed assets costing ₹ 10,000 was sold for ₹ 12,000 and the profit was included in P&L Account. You are required to prepare cash flow statement for 1992.

Notes

4. The following shows the balance in condensed from of Pavitra Ltd. At the beginning as well as at the end of the year 1987:

Liabilities	1.1.87 ₹	31.12.87 ₹	Assets	1.1.87 ₹	31.12.87 ₹
Creditors	52,000	47,500	Cash & Bank balance	45,000	45,000
Outstanding exp.	6,000	6,500	Debtors	38,500	26,500
8% Debentures	45,000	35,000	Investments	50,000	32,000
Depreciation fund	20,000	22,00	Prepaid exp.	500	1,000
Reserve for contingencies	30,000	30,000	Stock-in-trade	41,000	53,0000
P&L A/c	8,000	11,5000	Land & Building	77,000	77,000
Share capital	1,15,000	1,15,000	Machinery	24,000	33,000
	2,76,000	**2,67,5000**		**2,76,000**	**2,67,5000**

The following information is also available

(*a*) 10% dividend was paid in cash.

(*b*) New Machinery for ₹ 15,000 was purchased but old machinery costing ₹ 6,000 was sold for ₹ 2,000 on which accumulated depreciation was ₹ 3,000.

(*c*) ₹ 10,000 Debentures were redeemed by purchase from open market at ₹ 96 for a debenture of ₹ 100.

(*d*) Investments were sold at book value.

Prepare a Cash Flow statement

5. From the following balance you are required to calculate cash from operations:

Liabilities	31.12.89 ₹	31.12.90 ₹
P & L A/c balance	50,000	3,10,000
Debtors	90,000	84,000
Creditors	40,000	52,000
Bills Receivable	24,000	30,000
Prepaid expenses	3,200	2,800
Bills Payable	30,000	32,000
Outstanding expenses	2,400	3,200
Outstanding Income	1,600	1,800
Income received in advance	500	600

Notes

6. From the following Balance Sheets as on 31st December, prepare a Cash Flow statement and Adjusted P & L A/c.

Liabilities	31.12.200 ₹	31.12.2001 ₹	Assets	31.12.2000 ₹	31.12.2001 ₹
Share Capital	1,00,000	1,50,000	Fixed assets	1,00,000	1,50,000
P & L A/c	50,000	80,000	Goodwill	50,000	40,000
General Reserve	30,000	40,000	Inventories	50,000	80,000
16% Bonds	50,000	60,000	Debtors	50,000	80,000
Sundry creditors	30,000	40,000	Bill Receivable	10,000	15,000
Expenses outstanding	10,000	15,000	Bank	10,000	15,000
	2,70,000	**3,85,000**		**2,70,000**	**3,85,000**

7. The Comparative Balance Sheet of Mr. Wheldon for the two years were as follows:

Liabilities	1988 ₹	1989 ₹	Assets	1988 ₹	1989 ₹
Capital	1,50,000	1,75,000	Land & Buildings	1,10,000	1,50,000
Loan from Bank	1,60,000	1,00,000	Machinery	2,00,000	1,40,000
Creditors	90,000	1,00,000	Stock	50,000	45,000
Bills Payable	50,000	40,000	Debtors	70,000	80,000
Loan from IFC	-	25,000	Cash	20,000	25,000
	4,50,000	**4,40,000**		**4,50,000**	**4,40,000**

Additional Information:

Net profit of the year 1989 amounted to ₹ 60,000. During the year a machine costing ₹ 25,000 (accumulated depreciation ₹ 10,000) was sold for ₹ 13,000. The provision for depreciation against machinery as on 31-12-88 was ₹ 50,000 and on 31-12-89 ₹ 85,000. You are required to prepare a Cash Flow Statement.

8. The Balance Sheet of Thiruganauam Ltd., for the year 1989 and 1990 were as follows:

Liabilities	1989 ₹	1990 ₹	Assets	1989 ₹	1990 ₹
Share capital	1,50,000	1,75,000	Buildings	1,10,000	1,50,000
P & L A/c	1,20,000	80,000	Plant	2,00,000	1,40,000
Lon from bank	1,40,000	20,000	Stock	50,000	45,000
Creditors	85,000	93,000	Debtors	70,000	80,000
Outstanding exp.	5,000	7,000	Cash	15,000	22,000
Bills payable	50,000	40,000	Prepaid exp.	5,000	3,000
Loan from IFC	-	25,000			
	4,50,000	**4,40,000**		**4,50,000**	**4,40,000**

Additional Information :

(*a*) Net profit for the year 1990 ₹ 60,000.

(*b*) During the year a plant costing ₹ 25,000 (accumulated depreciation ₹ 10,000) was sold for ₹ 13,000.

(*c*) The provision for depreciation against plant as on 31-12-89 was ₹ 50,000 and on 31-12-90 was ₹ 85,000.

You are required to prepare a Cash Flow Statement.

Notes

9. The following are the Balance Sheet of Velavan Brothers Ltd., as on 31st, March 1986 and 1987.

Balance Sheet

Liabilities	31.3.87 ₹	31.3.86 ₹	Assets	31.3.87 ₹	31.3.86 ₹
Share capital	5,000	4,000	Fixed assets	4,000	4,1000
P & L A/c	320	300	*Less:* Depreciation	4,000	4,000
Debentures	700	600		1,500	1,100
				2,500	3,000
Creditors	1,400	1,700	Debtors	2,400	2,000
Provision of tax	420	300	Prepaid expenses	50	30
Proposed dividend	580	500	Preliminary exp.	300	500
Bank Overdraft	680	1,250	Cash	350	120
			Stock	3,500	3,000
	9,100	8,650		9,100	8,650

Additional Information :

1. Tax paid during the year ending 31.3.87 ₹ 350.
2. Dividend proposed during the year ending 31.3.87 ₹ 400.
3. Fixed assets coasting ₹ 700, accumulated depreciation thereon ₹ 300 were sold at book value

You are required to prepare a cash flow statement.