
Robert Leroy Kvam
Louisiana State University and Agricultural & Mechanical College

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A NEW FUNDS STATEMENT: A STATEMENT SUMMARIZING
FINANCIAL TRANSACTIONS

A Dissertation

Submitted to the Graduate Faculty of the
Louisiana State University and
Agricultural and Mechanical College
in partial fulfillment of the
requirements for the degree of
Doctor of Philosophy

in

The Department of Accounting

by

Robert Leroy Kvan
B.S., University of South Dakota, 1949
M.S., University of Colorado, 1952
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ABSTRACT

Management exercises financial stewardship as well as operating stewardship. It is the duty of management to report adequately on both types of stewardship. At the present time, there is no clear, understandable report concerning the financial stewardship.

It is the purpose of this study to attempt to devise a new type funds statement which presents a clear, understandable report of the financial transactions of a particular business unit. The approach made to this problem is (1) to examine the conventional funds statement to determine the information which it presents; (2) to examine other funds statements to determine what they present; and (3) to attempt to determine who the users of the statements are and what information the users need.

The conventional funds statement explains why the working capital of a business unit changed by showing the changes in the noncurrent accounts which have affected the working capital. The statement does not show the movement within the working capital area; consequently, the statement does not show short-term financing transactions. The statement does not show the changes concerning financing
which have occurred in the noncurrent accounts if the changes have not affected the working capital.

Although other funds statements present more information than the conventional funds statement, the other statements do not present the information in a clear, understandable manner so that people may use the information effectively.

The survey, studies, and interviews carried on during the course of this project indicate that the principal users of the funds statements are management, stockholders, bankers, accountants, and investor analysts. Although these people use the information for different and various purposes, much the same information is needed by all the users.

The users (combined) should have the following (overlapping) information: the reasons why the working capital of the business unit changed during the period; the reasons why the cash changed during the period; and a summary of the short-term and long-term financing transactions.

A New Funds Statement, devised during the course of this study, shows the above information. It is believed that the statement may be easily understood by the users because the cash position and working capital position are the centers of attention in the statement. The key figures in the statement may be traced to comparative balance sheets and the income statement. The New Funds Statement is titled, "Statement Summarizing Financial Transactions and Explaining Why the Cash and Working Capital Changed."
The New Funds Statement shows both short-term and long-term financing, shows how the operations have affected the working capital, and shows why the cash and working capital have changed during a certain period. Although the cash and working capital are the centers of attention, other financial transactions which have not affected the working capital or the cash are also shown on the statement.

The New Funds Statement, which contains two sections (a cash section and a working capital section) may be easily prepared without working papers. However, if there are many non-cash and/or non-working capital elimination entries, working papers may be used.

As the New Funds Statement does not contain the term, "funds," in its title, the ambiguity of the term, "funds," which has occurred in the past is eliminated.

Although the New Funds Statement reports on the financing transactions of the business unit, it also may be used by management in conjunction with budgets for planning and control purposes.
CHAPTER I
INTRODUCTION

Management exercises financial stewardship as well as operating stewardship; therefore it is the duty of management to report on both types of stewardship.¹

Although it is recognized that the center of managerial purpose is the operating activities, financial transactions are also important. The following is a quotation from Littleton:

Skillful financing keeps the amount of borrowing from becoming strongly undesirable; this is done by staying within careful limits, holding to a calculated risk. Getting into debt has come to be a regular feature of modern business. But it will be clear that productive enterprises are not formed merely to get into debt and to get out. Financial activities can hardly be at the center of managerial purpose. This center lies closer to the operating activities. Yet financial transactions are important and a report of financial stewardship is very much needed, especially when people outside of the enterprise are concerned. Unfortunately however, no clear and orderly accounting statement for this purpose has evolved that is comparable to the way the income statement fits its purpose.²


²Ibid., p. 81.
Accountants have devised a statement, called the funds statement, which explains many of the financing transactions which have occurred for a particular business unit during a certain period. Although there are various funds statements (explained in Chapter IV), the most commonly used funds statement is a statement showing why the working capital of a business unit changed during a specified period by showing the changes in the noncurrent accounts which have affected the working capital. For the purpose of this study, the latter type statement is termed, "the conventional funds statement."

Since the original funds statement, explained in Chapter IV, there have been many developments in fund statement concepts and presentation. This study is primarily concerned with the developments which have occurred within the last ten years.

PURPOSE OF THE STUDY

It is the purpose of this study to attempt to develop a better funds statement than the ones being used at the present time.

APPROACH AND ORGANIZATION OF THE STUDY

As the most common meaning of the term, "funds," is "working capital," an examination was made of this term. The results of this examination are presented in Chapter II.

3See Chapter V for the results of recent studies and surveys concerning the funds statement practices.
Chapter III contains a discussion concerning the conventional funds statement. The financial information which is generally omitted from the conventional funds statement is also presented in Chapter III.

After determining the information appearing in the conventional funds statement, and after determining the information which is generally omitted from the statement, other funds statements were studied to determine whether or not the other funds statements present information which is not found in the conventional statement. The data concerning the other funds statements appear in Chapter IV.

Various studies were made to determine: (1) how the funds statement is used in current practice; (2) what the most common meanings of the term, "funds," are; (3) what the most common title for the statement is; (4) who the users of the statement are; and (5) other pertinent information concerning funds statements. This involved examining various studies made by others; interviewing management, certified public accountants, and bankers; making a survey at the annual meeting of the Society of Louisiana Certified Public Accountants held at Lafayette, Louisiana, on May 23-24, 1957; and making a study of 100 annual stockholders' reports (mostly 1956 reports) filed in the Commerce Library of the Louisiana State University. Many of the 100 stockholders' reports were studied for periods of five to ten years in an
effort to determine trends of fund statement development. The results of the above named studies are presented in Chapter V.

After examining the conventional funds statement to determine what information it presents, after examining other funds statements to determine what they present, and after determining the information which the various users desire and need, an attempt was made to devise a new general purpose funds statement which will serve the users more adequately than other funds statements. The new funds statement is presented in Chapter VI.

Chapter VII contains a summary and the conclusions of this study.

LIMITATIONS OF THE STUDY

Although most of the discussion contained in this study may be applied to all types of business organizations, primary consideration is given to corporations engaged in manufacturing and merchandising operations.

The fund theory approach suggested by Vatter is not used in this study because this approach is not common in accounting practice in the United States today. The fund theory, in brief, holds that the business unit is divided into various groups. For example, one group might be the current group, another group the investment group, and a third group the
fixed asset group. Each of these groups, called a fund, is a separate entity.  

The study of R. K. Mautz, *An Accounting Technique for Reporting Financial Transactions*, is not included in this study because the Mautz statement does not come under the caption, "funds statements."

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CHAPTER II
WORKING CAPITAL

The term, "funds," has many meanings in today's accounting literature. For example, in the general accounting sense, the term means "... cash or other assets set apart for some specified purpose."\footnote{Wilbert E. Karrenbrock and Harry Simons, Intermediate Accounting (Comprehensive Volume; Chicago: South Western Publishing Company, 1953), p. 387.} In the governmental accounting sense a fund is a separate entity with its own self-balancing group of accounts.\footnote{Irving Tenner, Municipal and Governmental Accounting (Third Edition, New York: Prentice-Hall, Inc., 1955), p. 4.}

Concerning the funds statement, the term, "funds," has various meanings. The term, in the funds statement sense, means cash, cash or cash equivalent, not quick assets, total assets, working capital, or something else. It is shown in Chapter V that the most common meaning of the term, "funds," is "working capital." The various other meanings of the term are discussed in Chapter IV. It is the purpose in this chapter, to discuss the working capital concept and to determine why the concept is so important.
THE POOL OF VALUES THEORY

Each business enterprise contains a pool of assets,\(^3\) resources, or items which perform certain functions for the enterprise. While the accountant's balance sheet shows many of these assets, the balance sheet does not show many of the intangible assets such as the attitudes of customers toward the enterprise, the morale of the employees, the competence of the management, and many other important items.

The pool of assets of the business enterprise has claims against it. The claims are generally divided into creditors' claims, or liabilities, and owners' claims or owners' equities.

CLASSIFICATION OF ASSETS

The part of the pool of values presented on the balance sheet, to start with, is broken down into two main categories: current (circulating) and noncurrent (fixed). Adam Smith

\[^{3}\text{The following is Vatter's definition of the term, "assets:"}\]

"Assets are economic in nature; they are embodiments of future want satisfaction in the form of service potentials that may be transformed, exchanged, or stored against future events. Whatever means or method is employed to measure assets (cost, price, appraisal, or arbitrary valuation), assets are service potentials, not physical things, legal rights, or money claims."

mentions the two divisions when he writes that the capital of a business unit may be employed in two different ways so as to yield a profit to its employer. First, the capital may be employed in raising, manufacturing, or purchasing goods, and selling the goods for a profit. The capital employed in this manner yields no profit while it remains in the possession of the employer or continues in the same shape. The goods of the merchant yield no profit or revenue until the merchant sells them (goods) for money. The money is of little use to the merchant until he exchanges it (money) for goods. The merchant's capital is continually going from the merchant in one shape and returning to him in another shape. The moving of this capital (the successive exchanges) yields the merchant a profit. "Such capitals, therefore, may very properly be called circulating capitals." Second, the capital

"... may be employed in the improvement of land, in the purchase of useful machines and instruments of trade, or in such-like things as yield a revenue or profit without changing masters, or circulating any further. Such capitals, therefore, may be properly called fixed capitals."5

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5Ibid., pp. 262-263.
According to Paton, there are five tests or methods which may be applied in distinguishing between current and fixed assets. These tests are: (1) degree of liquidity; (2) normal term or length of life; (3) rate of transfer to expense or loss; (4) technical character or method of use; and (5) the nature of the business and intent of management.

Although each test in the above criteria is not entirely independent, each has some significance in itself. Liquidity means the speed of conversion into money or purchasing power without serious impairment of value. For example a bank account is very liquid, whereas a building or a unit of equipment is commonly a highly nonliquid asset. The second test refers to length of life regardless of other conditions. For example a 30 day accounts receivable is considered current, while a real estate mortgage owned, due in 10 years, is considered a noncurrent asset. The third and fourth tests are closely related and apply only to the assets consumed in the operations of the business unit. For example, a building passes slowly into operating expense whereas a certain stock of supplies usually is held for a comparatively short period. A piece of equipment is never consumed physically; however, a pile of coal is consumed in definite physical installments. The nature of the business

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and the purpose of the management also have a bearing on the classification of assets. Land in the hands of a real estate agent is in effect merchandise; however, land for a building site is clearly a fixed asset. A marketable security or cash held in a sinking fund is considered a noncurrent asset; however, cash and marketable securities used as working capital may be viewed as current assets. Sometimes it is difficult to label an asset as fixed or current because some assets are borderline cases.

Some critics have attempted to minimize the significance of the current-fixed asset classification by showing that the current assets represent for the most part revolving funds that are essentially fixed investments, permanent commitments necessary in the operations of the business unit. Of course the capital of the continuing business unit presumably is a permanent element, and the permanence of the capital pertains to the investment in all the assets of the unit; however, it does not follow that there is no useful basis for classifying assets. Although the cash in bank is an essential and continuing asset it is very true that the cash in bank is a different type of asset than land or buildings used in the operations of the business unit. Generally, current assets or resources represent purchasing power immediately available or shortly to become available whereas fixed assets, in general, are long-term, slowly revolving commitments, quite
unavailable as working capital. The latter fact is of considerable importance in the financial administration of the enterprise; it is not surprising that the accountant makes a distinction in the classifying process. 7

CURRENT ASSETS

Current assets may be divided into five main classes: (1) cash; (2) temporary investments, readily realizable; (3) short-term receivables; (4) inventories; (5) current prepayments. Cash is composed of money on hand (including all credit instruments functioning as money) and unrestricted bank balances. Marketable securities are generally considered current assets unless they are held for some special purpose (for example, securities in a sinking fund). The third division includes accounts, notes, drafts, and all other recognizable short-term claims to money or the equivalent. The fourth class, which is broad, covers items as office, store, factory, and shipping supplies as well as materials, work in progress, and saleable merchandise. Prepayments are composed of unexpired insurance premiums (if the period covered is not too long), prepaid rent, prepaid royalties, advances on orders, and similar items. 8

7 Ibid., pp. 8-9.

8 Ibid., p. 9.
From the above paragraphs it can be seen that there is a need to specify the period of time in which the materials will be consumed and in which, for example, the unexpired insurance premiums will expire. The committee on accounting procedure of the American Institute of Accountants advocates that a strict "one year" time period is not desirable because it is the tendency of creditors to rely more upon the ability of debtors to pay their obligations out of the proceeds of current operations and less upon the debtor's ability to pay in case of liquidation. Therefore, the time period is related to the operating cycle of the business unit. The following pertains to the operating cycle:

The ordinary operations of a business involve a circulation of capital within the current asset group. . . . . The average time intervening between the acquisition of materials or services entering this process and the final cash realization constitutes an operating cycle. A one-year time period is to be used as a basis for the segregation of current assets in cases where there are several operating cycles occurring within the year. However, where the period of the operating cycle is more than twelve months, as in, for instance, the tobacco, distillery, and lumber businesses, the longer period should be used. Where a particular business has no clearly defined operating cycle, the one year rule should govern.9

A problem arises in the above definition of the operating cycle. The problem concerns business units with more than one

product and with a different operating cycle for each product. It is reasonable to assume that if each cycle were longer than a year, an average might be used for the time period. However, as noted in the above paragraph, if no clear operating cycle exists, the one year rule should govern.

The following definition strengthens and summarizes the above discussion concerning the definition of current assets:

For accounting purposes, the term current assets is used to designate cash and other assets or resources commonly identified as those which are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business.10

NONCURRENT ASSETS

Although it is the purpose, in this chapter, to examine the working capital concept, the noncurrent assets are briefly examined to distinguish the noncurrent group from the current group which is included in the working capital.

Noncurrent assets may be divided into five groups: (1) land and other natural resources; (2) buildings and other structures; (3) equipment of all types; (4) noncurrent investments; (5) intangibles. The first group consists of land used as building sites and for right-of-way purposes, and wasting natural resources. Wasting assets may be subdivided into strictly nonreplaceable properties such as mines and oil

10 Ibid., p. 21.
wells, and replaceable assets such as timber, rubber plantations, and orange groves. Sometimes agricultural land, subject to erosion and loss of fertility, is considered as a wasting asset. The second and third groups, the depreciable assets, cover a wide range of types of property. Such structures as wharves, bridges, dams, mine shafts, water mains, and pavements are generally included in the "buildings" group. The third group, equipment, includes machines, appliances of all types, and such assets as cars, vessels, conveyors, fixtures, furnishings, tools, containers, dies, and patterns. Included in the fourth group are holdings of securities of affiliated companies, sinking funds, surrender values of life insurance, and all other noncurrent receivables and claims. Such assets as patents, trade-marks, trade names, copyrights, brands, franchises, and secret processes are included in the fifth group. Goodwill, if consideration is presented for it, is included in this group. Organization costs and development charges, properly capitalized, are also included in the "intangible" group.\footnote{Paton, \textit{op. cit.}, p. 10.}

CURRENT LIABILITIES

The term, "current liabilities," consists principally of obligations whose liquidation is reasonably expected to require the use of assets properly classified as current, or the
creation of other current liabilities. The following are included under the current liability caption: obligations for items which have entered into the operating cycle, such as payables incurred in the acquisition of materials and supplies to be used in the production of goods or in providing services to be offered for sale; collections received in advance of the delivery of goods or performance of services; and debts which arise from operations directly related to the operating cycle, such as accruals for wages, salaries, commissions, rentals, royalties, and income and other taxes. Other liabilities which are expected to be liquidated within a relatively short period of time, usually twelve months, are also included under the current caption. Examples of this last group of obligations are short-term debts arising from the acquisition of capital assets, serial maturities of long-term obligations, amounts required to be expended within one year under sinking fund provisions, and agency obligations arising from the collection or acceptance of cash or other assets for the account of third persons.  

Although it is shown later in this chapter that working capital is generally considered the current assets less the current liabilities, it seems appropriate to discuss briefly fixed liabilities, contingent obligations, and owners' equity.  

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FIXED LIABILITIES

Fixed liabilities or noncurrent liabilities are obligations which are not expected to require the application of current assets approximately within a year. Included in the noncurrent liabilities are obligations which will be satisfied by the application of noncurrent assets and obligations which, though maturing within approximately a year, will be refunded.13

CONTINGENT OBLIGATIONS

Obligations, which may be required under certain unfavorable circumstances which may eventuate but which have not yet occurred, can hardly be given definite recognition in the balance sheet except in the form of accompanying explanations and notes because such obligations do not constitute effective equities at the date of the statement. An ordinary contract which is wholly unperformed by both parties does not give rise to a recognizable liability. However, where it is estimated that a loss may occur in connection with any commitment which has been made, the situation should be called to the attention of the reader.14


14 Paton, op. cit., p. 15.
COMMON AND PREFERRED STOCK

The common and preferred stock should be adequately and fully explained. Information such as number of shares authorized, issued, and outstanding should be indicated.\(^\text{15}\)

OTHER CONTRIBUTED CAPITAL

Other contributed capital represents the amounts paid over the par value of the stock. Sometimes this caption is titled paid-in surplus. According to Kohler the principal sources of paid-in surplus are the excess over par or stated value received from the sale or exchange of capital stock; the excess of par or stated value of capital stock reacquired over the amount paid therefor, and surplus from recapitalization and donations.\(^\text{16}\)

RETAINED EARNINGS

"Retained earnings" represent accumulated net income less distributions to stockholders and transfers to capital-stock accounts. Retained earnings may be appropriated but the appropriations are part of the retained earnings. Ultimately the appropriated retained earnings are returned to the major retained earnings account.\(^\text{17}\)


\(^{17}\) Ibid., p. 164.
REVALUATIONS

If any surplus arises because of revaluations of assets, the write-up should adequately be explained and the surplus or credit relating to the write-up should not be shown as part of retained earnings or paid-in capital. It is very important to disclose any revaluations because it is against "generally accepted accounting principles" to write-up assets.

Although the primary purpose of the preceding discussion is to attempt to determine definitions for "current assets" and "current liabilities," the other basic information generally found on the balance sheet is presented to aid in showing differences between current assets, current liabilities, and the noncurrent accounts.

All of the assets described have basic functions. The liabilities are restrictions on the assets. It is the purpose in the following section to examine more closely the current assets and the current liabilities.

WORKING CAPITAL.

The working capital is defined as the excess of the current assets over the current liabilities. Working capital, therefore, is that fraction of the current assets which has been supplied by the permanent investors.18

18 Harry G. Guthmann and Herbert E. Dougall, Corporate Financial Policy (Third Edition; New York: prentice-Hall, Inc., 1955), p. 387. Although working capital is sometimes defined as current assets, in this study the term, "working capital" means the current assets less the current liabilities. Sometimes the latter definition means "net working capital." The term, "investors" in this paragraph means stockholders and bondholders.
**Circulation of current assets**

The main financial problem of management is to attempt to determine the need for liquidity and to maintain a regular movement of cash into other current or working assets and back again at the necessary rate. "A healthy circulation is as important to the corporation as it is to the human body."[19] The initial cash enters the business from owners or creditors. After entering the business the cash is maintained by the operating cycle of the business.

During the operating cycle the assets entering the working capital area should be greater than the ones leaving the area. In a successful business unit this gross operating profit element includes an amount which covers taxes and provides a return for the investors in the form of interest and dividends.[20]

If something interferes with the regular change in form of the assets from less current to more current, such as the freezing of inventories or receivables, the cash which is necessary to meet the cash outlays is not available. To avoid financial insolvency - the current assets must be kept moving, the management must keep a supply of excess cash or marketable securities to tide over a period of sluggish flow, or the

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management must have a reserve of borrowing power. The credit standing and financial solvency of the business depend on the successful meeting, by management, of the obligations of the business unit as the obligations mature. 21

It can be seen, from the above explanations, that the working capital of a business unit is extremely important to management, investors, stockholders, and others. However, there is one important fact which should be presented: the fact that management, even though it has an excess of current assets over the current liabilities, may use current assets for various purposes such as paying out too much cash for dividends, purchasing fixed assets with cash instead of using long-term financing, or doing other things which should not be done with the current assets. Competent management, of course, will use the current assets wisely and will meet the current liabilities as these obligations become due. It should be very important for management to report fully on the items entering the working capital area and the items leaving this area. The handling of the cash should also be reported by management; the above examples and explanations show the importance of the proper handling of cash and its related items.

21 Ibid., p. 389.
Recovered depreciation and like items

It was mentioned at the beginning of this chapter that the term, "fund," pertaining to the statement of funds, commonly means working capital. In this chapter, therefore, the meaning of the term "funds" is "working capital." It is also assumed that the business unit will continue on a "going concern" basis. Although the term, "depreciation," is used in the following discussion, the discussion also pertains to amortization (for example the writing-off of patents), and depletion (the writing-off of wasting assets).

It has been suggested by some people that depreciation "provides funds." This is not true. The assets coming into the business unit from revenues are the primary sources of funds. It is true that if the revenues are large enough to cover all expenses including depreciation and if cash dividends are declared for the full amount of the net income for the period, the funds show a net increase equal to the depreciation charge. Theoretically, the funds remaining in the unit, equalling the depreciation charge, should be used for the replacement of the fixed assets; however, these funds are used in the business and it is very difficult to determine where they may be. For a short time, at least, they will be in the working capital area.

Probably one of the reasons why people consider the depreciation charge "providing funds" is that studies have
been made showing "conversion of fixed into current assets through depreciation." One study, for example, showed that in 1932 "the depreciation earned and presumably recovered amounted to 11 per cent of the working capital for nine industries."\textsuperscript{22}

Although the results of the study previously described are probably true, the depreciation did not "provide funds." The term, "recovered," is very important because it means that the revenues were adequate to cover the expenses including depreciation. It should be emphasized that if the net income on the income statement were zero, the amount of the working capital would be increased by the amount of the depreciation charge because the revenues covered all of the expenses including the depreciation.

The purpose of depreciation is to calculate the expired value (on an historical cost basis) of a fixed asset and to match this expense along with other expenses with the revenues to attempt to determine a usable net income figure. The purpose of depreciation also could be to keep the capital of the company intact, to hold back assets to attempt someday to replace the fixed assets which have deteriorated. Of course, it is well known, that replacement is impossible with the assets "held back" by depreciation because these assets are used for various purposes and, especially now with rising prices, these "held back" assets are insufficient.

\textsuperscript{22}Ibid., p. 390.
Another common misconception which seems appropriate to consider here is that many people assume that because the 1954 Revenue Code allows greater depreciation in the earlier years of asset life than on, for example, a straight line computation, more funds come into the unit or depreciation "provides more funds." The same reasoning is used to explain this "phenomenon" as was used above.

In the latter case there is no doubt that more funds from current operations are available because the income taxes are lowered by the increased depreciation charge. The above comments mean not that more funds came into the company by revenues but that less funds had to leave the company in payment of income taxes. The conclusion that a company using the sum-of-the-digits method of depreciation for new assets instead of using the straight line method has more available funds (working capital) for a short time, at least, is correct. The statement that the increased depreciation "provided more funds" for the company is entirely wrong.

It should also be mentioned that in the long run all the costs of production, including a profit to the owners, must be covered by the revenues; therefore, the selling price, in the long run, must be set high enough to cover the preceding costs or the business will be in serious trouble. However, even looking at the situation in this light, it is still true that the revenues bring the added assets into the company.
In the short run, where the supply and demand of a certain product on the market, determines the price, the revenues still bring the added assets into the organization; however, in the short run the revenues may not be sufficient to cover the depreciation charges fully.

Although various studies show that over a long period of time the current asset section of the balance sheet increases and that these increases may be compared with the depreciation involved, this may not happen in many other cases because management may desire to use some or all of the excess current assets for other noncurrent purposes. It should be a well recognized fact that today many companies are not only using the assets held back by depreciation for noncurrent purposes but also that many companies are using the assets representing retained earnings for expansion purposes.

To further show that depreciation does not "provide funds" a simple example follows. Assume that the XYZ Company operates on strictly a cash basis except for the depreciation on a truck which is rented to other people. The truck and the cash are the only assets of the company. The truck cost $1,000 and is being depreciated over a five year life; $200 per year is the depreciation charge concerning the truck. Assume that the cash receipts for the year are $2,000 and that the cash disbursements are $1,200. The cash account for the year shows a net increase of $800. However, the income statement, with
the depreciation as a deduction, shows zero. While it is true, in this example, that the cash shows a net increase by the amount of the depreciation charge, the depreciation charge did not cause the increase; the increase in the cash occurred because the cash receipts covered both the cash disbursements and the depreciation charge.

In the preceding example, assume that the cash receipts amount to $1,800 instead of $2,000 and that the disbursements remain the same, $1,200. The cash shows a net increase of $600. The depreciation charge of $800 remains the same; therefore, the income statement shows a loss of $200. In this case, the cash is not increased by the amount of the depreciation charge because the cash receipts are not sufficient to cover both the cash disbursements and the depreciation.

Most business units do not operate on a cash basis but on an accrual basis. Sales are made on account, purchases are made on account, and adjustments are made for accrued wages and other items. Therefore, instead of using the cash account as a foundation, the working capital (the current assets less the current liabilities) is used.

**Significance of the funds statement**

Management uses budgets and estimates to attempt to anticipate future events. Management also uses information derived from financial statements to determine changes over
a period of time. The conventional funds statement, explained in the next chapter, is designed to show management and others why the working capital increased or decreased during a certain period. This statement summarizes the results of the financial activities of the business unit which affect the working capital.

Another purpose of the funds statement is to show why, for example, the working capital may have decreased while the income statement shows a net income. Although the funds statement does tell why the working capital increased or decreased, it does not explain why shifts among the items making up the current assets or current liabilities occurred. Management, investors, and others should make other tests, such as ratio analyses, to check solvency.

Importance of adequate working capital

The first requirement for preserving good trade and bank credit, for meeting all expenses and liabilities promptly, and for taking care of emergency and special needs is having adequate working capital. Although a sufficient working capital is necessary, an excessive amount may reduce the return on investment and encourage waste and manipulation. "Each dollar should do as much work as possible, but idle and unnecessary dollars might better be distributed to the

\[23\text{Ibid.}, \ p. \ 405.\]

\[24\text{Ibid.}, \ p. \ 405.\]
owners of the corporation or be used to reduce debts and save on interest charges."

As most firms are troubled with a scarcity rather than an excess of working capital, these firms have the problem of conserving the liquid resources. This conserving is performed by (1) avoiding contractual relations likely to prove a fatal drain upon cash in hard times; (2) avoiding any unnecessary investment in the operating current assets; and (3) operating efficiently so as to minimize losses and maximize profits, with the consequent effect upon working capital. Unnecessary investment should not be tied up in inventories and accounts receivable. Long-term bond issues and other long-term responsibilities should be carefully carried out so that the bond interest, sinking fund obligations, and long-term lease rent will not threaten insolvency. Considerable purchases of equipment on the installment plan should be carefully considered. The purchasing department or the management involved should keep supplies low by standardizing purchases and coordinating production closely with sales. The close cooperation between the sales and credit departments can minimize credit losses and expedite collections so that the investment in receivables is kept down.  

25 Ibid., p. 411.

26 Ibid., pp. 411-412. As mentioned before, management should use the current assets wisely. The working capital should not be endangered by management using current assets or incurring current liabilities in too great amounts for non-current purposes.
As practically all activities of a business unit have an effect on the current position, it is very important that working capital needs be properly estimated and controlled.

An estimate of the amount of cash needed is provided for in the cash budget. This needed cash may be provided by current receipts from operations or by loans. The amount of the cash needed to be obtained by loans may be for special, seasonal, or emergency purposes, or it may be for permanent current fund purposes. If the cash needed is only for temporary purposes, short-term bank loans may be obtained.

When the temporary cash receipts are not sufficient to cover the cash disbursement requirements, marketable securities are converted into cash, new loans are negotiated, trade debts and bank loans are renewed, special advances are obtained from friends, officers, directors, or stockholders, or special sources are used for loans such as finance and discount houses.

Although the cash budget can provide a plan, it is the responsibility of management to make sure that the plan is put into effect. After the budget is carefully prepared, periodic reports should be prepared showing how the budgeted figures compare with the actual figures. All differences between actual and estimated expenditures and receipts should be explained. "No budget will work as an automatic controller. But a carefully drawn budget in the hands of an efficient
management is a most valuable tool for the determination and control of current financial requirements."27

Summary

The business unit might be considered a pool of values. The values are represented by assets which may be defined as service potentials. Each asset has a particular function to perform for the business unit. The liabilities and owners' equities are considered restrictions on the assets.

The working capital of the business unit is defined as the current assets less the current liabilities. It is very important for the management to keep an adequate working capital to preserve good trade and bank credit, to meet all expenses and liabilities promptly, and to take care of emergency and special needs.

Current assets, for accounting purposes, are cash and other assets commonly identified as those which are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business.

Current liabilities consist of obligations which are reasonably expected to be liquidated by current assets.

27Ibid., pp. 412-413.
CHAPTER III

THE CONVENTIONAL FUNDS STATEMENT

It is the purpose of this chapter to explain the conventional funds statement. As stated earlier in this study, the conventional funds statement is a statement showing why the working capital of a business unit changed during a specified period by showing the changes in the noncurrent accounts which affected the working capital. In this chapter, the term, "funds," means "working capital."

SOURCES OF FUNDS

Items flow into the funds area from the following sources: (1) proceeds from sale of noncurrent assets; (2) proceeds from issuance of noncurrent liabilities; (3) proceeds from issuance of common and preferred stock; and (4) revenues from operations.

The sale for a price different than the book value of a noncurrent asset for cash decreases the book value of the

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1The following references were used, generally, for this chapter concerning the conventional funds statement: (As this is a commonly used statement, it can be found in many accounting text books.) H. A. Finney and H. E. Miller, Principles of Accounting Intermediate (Fourth Edition; New York: Prentice-Hall, Inc., 1953), pp. 615-653; W. E. Karrenbrock and H. Simons, Intermediate Accounting Comprehensive Volume (Chicago: South-Western Publishing Company, 1953), pp. 851-876; Arthur W. Holmes and R. A. Meier, Intermediate Accounting (Revised Edition; Homewood, Illinois: Richard D. Irwin, Inc.), pp. 746-775. Information from other sources is noted in footnotes.
noncurrent asset, increases the gain or loss account (or increases or decreases earned surplus), and increases the cash by the amount of the proceeds of the sale. For example, assume that a truck with an original cost of $2,000, with an allowance for depreciation of $600 (adjusted to date of sale), is sold for $1,300 cash. The funds (working capital), in this example, are increased by the amount of the cash proceeds, $1,300.

In the preceding example, the information concerning the sale of the truck is found by analyzing the fixed asset account, the allowance for depreciation account, and the earned surplus account or the income statement (depending on where the gain is placed). In this study, the gains and losses are considered to be material; therefore, both gains and losses are found in the earned surplus (retained earnings) account. In other words, the current operating concept (instead of the all inclusive) income statement is assumed. The important point in the previous discussion is that the working capital is increased in the amount of $1,300. The increase is explained by the fact that the truck account book value decreased in the amount of $1,200 and earned surplus increased in the amount of the gain, $100.

The sale of any other noncurrent asset, where the proceeds enter the working capital area, is analyzed and handled in approximately the same way as the sale of the truck explained in the preceding paragraphs.
The proceeds derived from the sale of bonds (long-term liabilities) increase the working capital. For example, assume that bonds of $100,000 face value are sold at 102. In analyzing the accounts, it appears that the working capital increased $102,000. The increase is explained by the fact that the bond account increased $100,000 and the premium on bonds increased $2,000. It should be noted that the funds do not show an increase if the bonds are issued directly for a noncurrent asset or for the liquidation of another non-current liability because these latter transactions do not affect working capital.

If common or preferred stock is sold, the working capital is increased by the amount of the proceeds from the sale. Assume that preferred stock, par value - $10, is issued for $11, and that 1,000 shares are issued (fully paid). The working capital is increased in the amount of $11,000. The increase in working capital is explained by the fact that the preferred stock account increased $10,000 and the premium on preferred stock increased $1,000.²

The revenues from operations increase the working capital because in most companies the revenues are sales. As the

²The issuance of preferred or common stock in exchange for a noncurrent asset or in the conversion of stock for bonds is not shown on the conventional funds statement because these transactions have no effect on working capital.
sales increase, in the double entry system of accounting, the accounts receivable increase because, generally, sales are made on account. If sales are made for cash, of course, the sales account increases and the cash increases. Gains or losses for items not directly connected with the operations of the business sometimes are considered revenues if these items are not material. However, as stated before, gains and losses are considered to be material in this study and will appear either as additions (gains) or deductions (losses) in the earned surplus (retained earnings) statement. It is explained in a following section of this chapter that the conventional funds statement does not show the revenues from the operations separately from the operation expenditures, but shows the net increase in working capital which occurred from the operations for the period.

In this study it is assumed that the "reserve" method is used for bad debt losses. In other words, management knows approximately (from past period analysis) what the bad debt loss is, either as a percentage of accounts receivable or of sales, and the revenues (sales) are reduced accordingly. The entry usually made for the reduction in revenues and the reduction of accounts receivable to realizable value is a charge to bad debt expense and a credit to the allowance for bad debts. When an account is definitely known to be bad, the account is written off by charging the allowance for bad debts and crediting (decreasing) the accounts receivable.
By using the "reserve" method for bad debts, the working capital is increased by the revenues (total sales) less the estimated bad debt charge. If an account is written off during the period, the write-off has no effect on funds because two accounts within the working capital area are decreased simultaneously (allowance for bad debts and accounts receivable).

From the above paragraph it can be seen that the conventional funds statement does not show the movement within the working capital group of accounts. This is a very significant point because the short-term financing is not shown on the conventional statement. For example, if a certain company borrowed $10,000 from the bank and gave a 30 day note, the transaction would not appear on the conventional statement because the working capital was not affected (cash, a current asset, increased; notes payable, a current liability, increased).

The preceding items flowing into the working capital area are called "sources" of funds; however, the caption in the funds statement showing these items is sometimes called "funds provided."

USES OF FUNDS

Funds are generally used for the following purposes: (1) to retire capital stock; (2) to retire long-term debt; (3) to acquire noncurrent assets; (4) to declare a cash dividend; (5) for operating expenditures.
The working capital is decreased by the amount required to retire capital stock, assuming that there is no sinking fund. Assume, for example, that 100 shares of preferred stock originally issued at 101, are retired during the period at 102. The working capital decreased $10,200. The decrease is explained as follows: the preferred stock account decreased $10,000; the premium on preferred stock decreased $100; and the retained earnings account decreased $100.

The working capital is decreased by the amount required to retire term bonds, assuming that there is no sinking fund. For example, assume that term bonds are called at 103, that the bonds were originally issued at 101, that the book value of the bonds is 102 1/2 at the date of the call, and that bonds in the amount of $1,000 (face value) are called. The working capital is reduced by $1,030. The reduction in working capital is explained as follows: the bond account decreased $1,000; the premium on bonds decreased $25 after it had been adjusted for the current period to the date of the call; earned surplus decreased $5 representing the loss on the retirement.

Working capital is reduced when the amount of serial bonds to be paid in the near future is moved from the fixed liability section of the balance sheet to the current liability section. For example, assume that at the end of a
year serial bonds which will come due within a short time during the next year are moved from the fixed liability section to the current liability section; in this case working capital is reduced by the amount of the bonds which was moved into the current liability section. Working capital, in this case, would not be reduced when the serial bonds are paid because cash is decreased and the current liability, serial bonds payable, is decreased at the same time as the payment. Concerning serial bonds, the working capital is reduced in the period when the bonds are moved from the fixed liability section to the current liability section - not in the period when the serial bonds are paid.

When bonds and stock are retired from a sinking fund, the working capital is not affected because the sinking fund is not a current asset. For example, assume that term bonds with a maturity value of $100,000 are retired through a sinking fund. The sinking fund is reduced $100,000 and the long-term liability is reduced $100,000; there is no effect on working capital.

When noncurrent assets are acquired either by the issuance of cash or another current asset or by the incurrence of a current liability the working capital is reduced. For example, if a new building is purchased for $100,000 cash, the working capital is reduced $100,000. The explanation for the reduction of the working capital is that the building increased $100,000.
If a fixed asset is traded for another fixed asset, the working capital is reduced only for the amount of the "boot." For example, assume that a truck with a book value of $500 is traded for a new truck with a list price of $2,000, and that a trade-in-allowance of $700 is given for the old truck. The working capital is reduced in the amount of $1,300 (the amount of "boot," assuming cash is given or that a short term liability is incurred). The reduction in working capital is explained as follows: the book value of the old truck decreased $500; the book value of the new truck increased $2,000; and the retained earnings account (gain) increased $200.

The decrease in working capital used to acquire any non-current asset is handled in approximately the same way as in the examples in the preceding paragraph. An exchange of one noncurrent asset for another noncurrent asset does not appear on the conventional funds statement because the working capital is not affected.

In the declaration of a cash dividend, the retained earnings account is decreased and the current liability account is increased; therefore, the declaration of a cash dividend decreases working capital and is considered a use of funds. The payment of a cash dividend which has been declared has no effect on funds because the cash decreased and the current liability, dividends payable, decreased simultaneously.

Funds are used for operating expenditures. The term, "expenditures," means the reduction of current assets, and/or
incurrence of current liabilities where these transactions have an effect on the operations of the company. In other words, operating expenditures are reductions in working capital where the reductions are used directly in the operations of the business unit. Examples of operating expenditures are wages, rent, taxes, interest, cost of goods sold, and various other operating items. Of course the primary aim of management is to make a profit on operations. In order to make a profit the revenues must cover the operating expenditures and non-fund charges such as depreciation, depletion, amortization, and nonoperating losses. It should be noted that the operating expenditures and the revenues are both considered to be on the accrual basis of accounting on the income statement; the same accrual basis is used in the conventional statement of funds, although the non-fund items such as depreciation, depletion, and amortization are not expenditures because these items do not affect working capital; therefore, the non-fund charges are eliminated from the expenses shown on the income statement so that only the operating expenditures will be shown on the funds statement as reductions of working capital.

In the conventional funds statement the revenues and expenditures are not usually shown separately as the preceding discussion has indicated, but a caption in the statement titled "funds provided by operations" shows the net increase in the
working capital caused by the operations of the business unit. The "funds provided by operations" may be computed by two methods. First, it can be computed by deducting the operating expenditures (excluding depreciation, depletion, amortization, and other non-fund charges) from the revenues, or, second, it can be computed by adding the non-fund charges such as depreciation, depletion, and amortization to the net income figure shown on the income statement. The second method is the one generally used in connection with the conventional funds statement.

The preceding discussion included revenues as a source of funds and operation expenditures as a use of funds because the effect of operations on the funds is more clearly shown if operations are broken down in this fashion. The idea for the breakdown in operations is presented by Paton and Paton. 3

As was mentioned in the preceding chapter, the income statement may show a loss and there still may be an increase in funds. For example assume that the income statement shows the following:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>$10,000</td>
</tr>
<tr>
<td>Expenses (excluding</td>
<td>$9,000</td>
</tr>
<tr>
<td>depreciation)</td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>2,000</td>
</tr>
<tr>
<td>Net Loss</td>
<td>$ 1,000</td>
</tr>
</tbody>
</table>

The example shows that even though the income statement shows a net loss of $1,000, the working capital was increased in a net amount of $1,000 from the operations of the business unit (net loss $1,000 plus depreciation, $2,000 = $1,000).

If the sources of working capital are greater than the uses of working capital on the conventional funds statement, the working capital shows a net increase. If the uses of working capital are greater than the sources of working capital, the statement, of course, shows a net decrease in working capital.

OTHER IMPORTANT CONSIDERATIONS

Although the preceding discussion covers the basic parts of the conventional funds statement, there are other important aspects which should be considered.

**Depreciation and other non-fund charges in ending inventories**

In a manufacturing company, the current depreciation and other non-fund charges which have attached to the ending inventories might be considered a source of funds because these charges have increased the current asset, inventory. The charges in the beginning inventory have no effect on current funds; the charges in the beginning inventory are considered to have increased the working capital in the previous period.4

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Other changes in noncurrent accounts having no effect on working capital

There are many changes within the noncurrent asset, noncurrent liability items, and the capital (owners' equity) items which have no effect on funds. For example, appraisals entered into the accounts during the period under review, noncurrent assets charged off against earned surplus, stock dividends, and other changes within the noncurrent accounts have no effect on working capital, and consequently, are not shown on the conventional funds statement.

Inventory valuation

It is well known among accountants and businessmen that, in a period of rising prices, lower net incomes are shown under the last-in, first-out (LIFO) method of inventory pricing than are shown under the first-in, first-out (FIFO) method. The reason for this is that cost of sales is charged at current prices under LIFO and at earlier (lower in a rising price situation) prices under FIFO. This means that identical companies with different inventory valuations, having identical assets and identical operations, would have different net incomes. In a period of rising prices, the company using LIFO would have a lower net income than the company using FIFO. In a period of falling prices, the company using FIFO would have a lower income than the one using LIFO. Therefore, concerning the funds statement, in a period of rising prices, less funds are provided by operations in the company using
LIFO than in the one using FIFO. In a period of falling prices, less funds are provided by operations in the company using FIFO than in the one using LIFO.

Of course, these identical companies would have different valuations on their inventories on the balance sheets. For example, assume the above company using LIFO started this method in 1940 and has the same base amount in its inventory at December 31, 1957. The inventory, in this case, would be priced at 1940 prices. The company using FIFO would have its inventory priced at 1957 prices.

In analyzing the funds statement as well as the balance sheet and income statement, the reader should be aware of the inventory pricing. All financial statements which have inventories included should show the valuation methods. The showing of the inventory pricing is the common practice of certified public accountants.5

Gain or loss on sale of marketable securities

Marketable securities are classified as current assets. If marketable securities are sold for the same amount as the book value, no gain or loss arises. However, if the securities are sold at an amount above the book value, a gain arises, and the working capital is increased by the amount of the gain. If the securities are sold at a loss the working capital would

be decreased by the amount of the loss, and the loss would show on the conventional funds statement in the "use" section.

As mentioned before the gain or loss on the sale of non-current assets would not be shown on the conventional funds statement; however, the proceeds from the sale would be shown in the "sources" section of the statement.

PREPARATION OF FUNDS STATEMENT

The conventional funds statement is prepared by analyzing the differences in comparative balance sheets; by analyzing the changes in the retained earnings (or proprietor's capital) account; by analyzing the income statement; and by using other information taken from the records of the business unit. All changes in the noncurrent accounts are explained; however, only the changes which affect working capital are shown on the funds statement. Although most accounting textbooks emphasize the importance of developing adequate working papers for preparing the funds statement, certified public accountants use working papers only in the more complicated situations. The preparation of working papers for the ordinary company experiencing only a few non-fund transactions is a waste of time. 6 If working papers are prepared they are similar to the working papers contained in Appendix C which concerns the "New Funds statement."

**Illustration 1 - Preparation of Conventional Funds Statement for Small Merchandising Company.**

The following illustration shows how the conventional funds statement is prepared for a small business unit. Assume that this unit is a small merchandising unit owned by a single proprietor.

**B Company**

**Comparative Balance Sheets**

<table>
<thead>
<tr>
<th></th>
<th>December 31 1950</th>
<th>December 31 1951</th>
<th>Net Change (dr - cr)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash</strong></td>
<td>$10,000</td>
<td>$20,000</td>
<td>$10,000</td>
</tr>
<tr>
<td><strong>Accounts Receivable (net)</strong></td>
<td>5,000</td>
<td>6,000</td>
<td>1,000</td>
</tr>
<tr>
<td><strong>Plant and Equipment (net)</strong></td>
<td>11,000</td>
<td>10,500</td>
<td>$500</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$26,000</td>
<td>$36,500</td>
<td>$10,500</td>
</tr>
<tr>
<td><strong>Current Liabilities</strong></td>
<td>$5,000</td>
<td>$7,000</td>
<td>$2,000</td>
</tr>
<tr>
<td><strong>Capital</strong></td>
<td>21,000</td>
<td>29,500</td>
<td>8,500</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$26,000</td>
<td>$36,500</td>
<td>$11,000</td>
</tr>
</tbody>
</table>

**B Company**

**Analysis of Capital**

<table>
<thead>
<tr>
<th></th>
<th>January 1, 1951</th>
<th>December 31, 1951</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance</strong></td>
<td>$21,000</td>
<td>$29,500</td>
</tr>
<tr>
<td><strong>Net Earnings</strong></td>
<td>$9,500</td>
<td></td>
</tr>
<tr>
<td><strong>Less: Withdrawals</strong></td>
<td>$1,000</td>
<td>8,500</td>
</tr>
<tr>
<td><strong>Balance, December 31, 1951</strong></td>
<td>$20,500</td>
<td></td>
</tr>
</tbody>
</table>

**B Company**

**Income Statement**

For the Year Ended December 31, 1951

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount 1950</th>
<th>Amount 1951</th>
<th>Difference (dr - cr)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sales</strong></td>
<td>$30,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Expenses (excluding depreciation)</strong></td>
<td>$20,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Depreciation</strong></td>
<td>$500</td>
<td>20,500</td>
<td></td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td></td>
<td>$9,500</td>
<td></td>
</tr>
</tbody>
</table>

7The accounts receivable and plant and equipment are shown "net" for illustrative purposes. Of course, on the formal balance sheet the allowance for bad debts and the allowance for depreciation would be shown.
Pertaining to illustration 1, the funds statement can easily be prepared from the comparative balance sheets and the analysis of capital. The income statement would not be necessary, in this case, for the preparation of the funds statement since the depreciation charge can be found (assumed) by comparing the plant and equipment balance at December 31, 1950 with the balance at December 31, 1951. However, in many cases, the plant and equipment will have increases for additional assets purchased during the period and will have decreases for the depreciation charge and for items in this section which left the business unit; therefore, usually more investigation is required by the accountant to show the actual changes in the plant and equipment group.

The following funds statement shows that the net income provided funds of $10,000 even though the income statement shows a net income for the period of $9,500. The revenues (items entering working capital area) exceeded the expenditures (items leaving the working capital area) by $10,000. As the depreciation charge has no effect on working capital, it is eliminated by being added to the net income figure appearing on the income statement.

The conventional funds statement prepared from the preceding information appears as follows:
B Company
Statement of Funds
For the Year Ended December 31, 1951

Funds provided:
By operations:
(Net income per income statement $9,500
plus adjustment for depreciation $500) $10,000

Funds applied:
Withdrawals by owner 1,000

Increase in working capital $9,000

The increase in working capital is accountable as follows:

Working capital items December 1950 1951 Working Capital Increase Decrease
Current assets:
Cash $10,000 $20,000 $10,000
Accounts receivable 5,000 6,000 1,000

Current liabilities:
5,000 7,000

Net increase (as above) $11,000 $2,000 $9,000

$11,000 $11,000

Figure 1 - Conventional Funds Statement

8The model for this funds statement with slight modification can be found in some intermediate textbooks. See the following: (1) Finney and Miller, op. cit., p. 627; (2) Holmes and Meier, op. cit., p. 754; (3) Karrenbrock and Simons, op. cit., p. 854.
Illustration 2 - Preparation of Conventional Funds Statement For A Manufacturing Company

Illustration 2 pertains to a manufacturing corporation which has, among its current assets, finished goods and work in process inventories. It is assumed that the depreciation charge attached to these December 31, 1951, inventories is $10,000. The following information is presented:

X Corporation
Comparative Balance Sheets

<table>
<thead>
<tr>
<th></th>
<th>December 31</th>
<th>net changes</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1950</td>
<td>1951</td>
</tr>
<tr>
<td>Working Capital</td>
<td>$200,000</td>
<td>$235,000</td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>300,000</td>
<td>350,000</td>
</tr>
<tr>
<td>Total</td>
<td>$500,000</td>
<td>$585,000</td>
</tr>
<tr>
<td>Allowance for</td>
<td>$50,000</td>
<td>$71,000</td>
</tr>
<tr>
<td>depreciation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bonds payable</td>
<td></td>
<td>10,000</td>
</tr>
<tr>
<td>Common Stock</td>
<td>400,000</td>
<td>410,000</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>50,000</td>
<td>94,000</td>
</tr>
<tr>
<td>Total</td>
<td>$500,000</td>
<td>$585,000</td>
</tr>
</tbody>
</table>

9Note: The current assets and current liabilities are not listed separately in this example. The primary purpose is to show how the working capital area is affected by happenings in non-current assets, non-current liabilities, and owners' equity items.
X Corporation
Income Statement
For the Year Ended December 31, 1951

Revenues $100,000

Expenses other than depreciation $27,000

Depreciation (including depreciation in cost of goods sold, excluding depreciation in inventories 12-31-51) 20,000 47,000

Net Income $ 53,000

The following analyses are also required for a proper funds statement:

Analysis of Retained Earnings

Balance, January 1, 1951 $ 50,000
Add: Gain on trade of machine $ 1,000
Net Income 53,000 54,000 $104,000
Less: Stock Dividend 10,000
Balance, December 31, 1951 $ 94,000

Analysis of Fixed Assets (original cost)

Balance, January 1, 1951 $300,000
Deduct: original cost of machine traded 10,000 $290,000
Add: Machine received on trade $11,000
Other machine purchased 49,000 60,000
Balance, December 31, 1951 $350,000
Analysis of Allowance for Depreciation

Balance, January 1, 1951 $50,000
Less: Amount written-off pertaining to machine traded $9,000
Add: Depreciation for year $30,000
Balance, December 31, 1951 $71,000

Further analysis shows that the machine was traded on January 1, 1951 and that the following entry was made:

\[
\begin{array}{ccc}
\text{dr} & \text{cr} \\
\text{Fixed Assets (new Machine)} & $11,000 \\
\text{Allowance for Depreciation} & 9,000 \\
\text{Fixed Assets (old Machine)} & $10,000 \\
\text{Cash} & 9,000 \\
\text{Gain on trade} & 1,000 \\
\end{array}
\]

From the above information the following funds statement might be prepared:

X Corporation
Statement of Funds
For the Year Ended December 31, 1951

Funds Provided:
Operations: (net income adjusted for depreciation - 53,000 + 20,000) $73,000
Depreciation charge in inventories - 12/31/51 10,000
From sale of bonds 10,000
Total Funds Provided $93,000

Funds Applied:
To acquire new machine on trade $ 9,000
Other machine 49,000 58,000
INCREASE IN WORKING CAPITAL $35,000

Figure 2 - Conventional Funds Statement
In the second illustration, even though the comparative balance sheets show an increase of $50,000 to the fixed asset group, funds actually were expended to the amount of $58,000. This is explained from the fixed asset analysis. The machine received from the trade had a list price of $11,000 and the machine purchased for cash amounted to $49,000 (total $60,000). However, the old machine traded decreased the fixed asset account by $10,000 ($60,000 less $10,000 equals $50,000). The "boot" or cash given on the trade ($9,000) plus the cash given for the other machine ($49,000) equals the funds applied for the fixed asset increase, or $58,000.

The second illustration shows that a stock dividend decreased retained earnings and increased common stock by $10,000. This transaction had no effect on funds and is therefore not shown in the funds statement.

The net income per income statement, $53,000, adjusted for the depreciation charge which went into operations, $20,000, shows that operations caused a net increase in working capital of $73,000. The depreciation charge in the ending inventories increased working capital $10,000.

The bonds were evidently sold at par. This transaction provided funds of $10,000.

The second illustration shows, among other things, that working with comparative balance sheets alone does not present sufficient evidence to prepare a conventional funds statement. Usually more information is needed.
The depreciation charge in the ending inventories, mentioned previously, is presented to show one case where depreciation might be considered a source of funds. It seems that the depreciation charge in the inventories is very seldom, if ever, shown as a source of funds because it would be very difficult and impractical to attempt to determine the depreciation in the ending inventories and very few would understand the significance of the presentation.

The depreciation charge in the beginning inventories, mentioned previously, of a manufacturing concern has no bearing on funds. This charge could be considered as providing funds in an earlier period. The depreciation charge in the ending inventories, mentioned above, means only the current depreciation charge (that element in the fixed asset group which had moved into the current asset group, inventories, during the period being considered and remaining in the current group at the end of the period).

In the second illustration, management and others may see that the working capital was increased during the period by the following: operations, $73,000; depreciation charge in ending inventories, $10,000; and sale of bonds, $10,000. Working capital was decreased $58,000 to acquire machines. Now it is up to the management to decide whether or not the working capital at the new level is required; whether or not dividends should be declared; whether or not loans, short-term
or long-term, will be needed in the future; what the future expansion program will be; and other significant financing decisions.

As the working capital position of the business unit is very important, and as the conventional funds statement shows the items entering the working capital area and the items leaving the area, the conventional funds statement is a very important tool for management. The statement is very important for investors, bankers, and others because it shows the financing transactions which affect the working capital.

**Summary**

The conventional funds statement shows why the working capital of a business unit changed by showing the changes in the noncurrent accounts which affected the working capital.

The primary sources of working capital are: (1) the proceeds from the sale of noncurrent assets; (2) the proceeds from the issuance of noncurrent liabilities; (3) the proceeds from the issuance of common and preferred stock; and (4) the revenues from operations.

The primary uses (applications) of funds (working capital) are: (1) the retirement of capital stock; (2) the retirement of long-term debt; (3) the acquisition of noncurrent assets; (4) the declaration of cash dividends; and (5) operating expenditures.

In the conventional funds statement the revenues and expenditures are not usually shown separately, but a caption
The "funds provided by operations" may be calculated in two ways. First, the operating expenditures (excluding the depreciation, depletion, amortization, and other non-fund charges) may be deducted from the revenues. Second, the "funds provided by operations" may be calculated by adding the depreciation, depletion, amortization, and other non-fund charges to the net income shown on the income statement. The second method is the one most commonly used with the conventional funds statement.

The depreciation charge (also the depletion, amortization, and other non-fund charges) in the ending inventories might be considered a source of funds because this charge increases the working capital.

Although the conventional funds statement shows the changes in the noncurrent accounts when the changes affect the working capital, the conventional funds statement does not explain the changes within the working capital group because these changes do not affect the total working capital; therefore, the conventional funds statement does not explain short-term financing. For example, bank loans ordinarily are not shown on the conventional funds statement.
The conventional funds statement does not show the changes in the noncurrent accounts when these changes do not affect the working capital. Therefore, if stock or bonds were issued for a building, the transaction would not appear on the conventional funds statement.

The conventional statement is prepared by analyzing the differences in the items on comparative balance sheets; by analyzing the changes in the retained earnings account; by analyzing the income statement; and by using other information taken from the records of the business unit.

Although the conventional funds statement explains why the working capital increased or decreased, it is up to the management to determine how to use the information to plan the future financing activities of the company. It is up to the stockholders, bankers, and others to determine whether or not the management financed the business unit properly.
It was mentioned in the last chapter that certain facts concerning financing are not shown on the conventional funds statement. For example, the conventional funds statement does not explain short-term financing because it does not show the movement of the various items within the working capital group. The conventional funds statement does not show the changes in the noncurrent accounts if the changes do not affect the working capital.

It is the purpose of this chapter to introduce and to show other types of funds statements, to show how these statements differ from the conventional funds statement, and to show the additional information presented by these other statements.

The other funds statements covered in this chapter are as follows: the "original funds statement," the "all-inclusive funds statement," the "Paton funds statement," the "net quick asset funds statement," and the "cash flow statement."

THE ORIGINAL FUNDS STATEMENT

William Morse Cole, Professor of Accounting in Harvard University, explains the "Where got, Where gone" statement in
his book, *Accounts Their Construction and Interpretation*, published in 1906. Professor Cole writes that the first "Where got, where gone" statement was used by the railroad companies in 1903. In this study, the "Where got, Where gone" statement is referred to as the "original funds statement."

The original funds statement is prepared from comparative balance sheets. No other information is necessary.

The first requirement of the interpretation is the realization that nothing on the balance sheet increases or decreases without an equivalent. In other words, it is assumed that the books are operated on a double entry system.

Cole writes that it is evident that an increase in an asset (resource) account indicates that something has been spent to acquire the increased asset. Similarly, a decrease in a liability account indicates that a liability or part of it has been retired and something spent. Conversely, a decrease in an asset account indicates that something has been taken from this account during the year and spent elsewhere; or, the decrease is part of an exchange of one asset for another. An increase in a liability account indicates that the firm has borrowed some sort of property and has some additional assets to spend. From making an analysis of the

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two balance sheets and by tabulating the increases and decreases of assets and liabilities, one can see from what sources all receipts came and to what destination all expenditures went.2

Cole included the net worth items under the "liability" caption. He set up his statement directly from comparative balance sheets; no other information was needed. His statement merely summarizes the increases and decreases of assets, liabilities, and net worth items arising from the comparative balance sheets. Although this statement is crude compared with the more modern funds statement, it should be remembered that this was prepared and devised before even the income statement became a regular part of annual reports. This original statement probably helped analysts, especially, attempt to determine the happenings of the business unit for the year, although this original statement or any other funds statement usually was not included in the annual report until a much later period.

Illustration 3 - Preparation of the Original Funds Statement

The following illustration is presented to show how the original funds statement is prepared. Assume that the following comparative balance sheets were prepared from the records of the Y Merchandising Company:

---

2Ibid., pp. 97, 98. Although Cole explains the changes shown on the comparative sheets fairly well, it is admitted that his terminology is rather crude.
### Y Corporation

**Comparative Balance Sheets**

<table>
<thead>
<tr>
<th></th>
<th>December 31</th>
<th>Net Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1950</td>
<td>1951</td>
</tr>
<tr>
<td></td>
<td></td>
<td>dr</td>
</tr>
<tr>
<td><strong>Cash</strong></td>
<td>$20,000</td>
<td>$25,000</td>
</tr>
<tr>
<td><strong>Accounts Receivable (net)</strong></td>
<td>35,000</td>
<td>60,000</td>
</tr>
<tr>
<td><strong>Inventories</strong></td>
<td>180,000</td>
<td>170,000</td>
</tr>
<tr>
<td><strong>Prepaid Expenses</strong></td>
<td>10,000</td>
<td>9,000</td>
</tr>
<tr>
<td><strong>Fixed Assets (net)</strong></td>
<td>250,000</td>
<td>329,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$495,000</td>
<td>$593,000</td>
</tr>
<tr>
<td><strong>Accounts Payable</strong></td>
<td>$10,000</td>
<td>$5,000</td>
</tr>
<tr>
<td><strong>Loans Payable</strong></td>
<td>5,000</td>
<td>15,000</td>
</tr>
<tr>
<td><strong>Income Tax Payable</strong></td>
<td>20,000</td>
<td>25,000</td>
</tr>
<tr>
<td><strong>Accrued Expenses</strong></td>
<td>10,000</td>
<td>9,000</td>
</tr>
<tr>
<td><strong>Bonds Payable</strong></td>
<td></td>
<td>60,000</td>
</tr>
<tr>
<td><strong>Common Stock</strong></td>
<td>400,000</td>
<td>410,000</td>
</tr>
<tr>
<td><strong>Retained Earnings</strong></td>
<td>50,000</td>
<td>69,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$495,000</td>
<td>$593,000</td>
</tr>
</tbody>
</table>

**Total**
The following original funds statement is prepared by using only the information which appears on the comparative balance sheets:

Y Corporation
Where got - Where gone Statement
For the Year Ended December 31, 1951

<table>
<thead>
<tr>
<th>Where got (or Receipts or Credits)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventories</td>
<td>$10,000</td>
</tr>
<tr>
<td>Prepaid Expenses</td>
<td>1,000</td>
</tr>
<tr>
<td>Loans Payable</td>
<td>10,000</td>
</tr>
<tr>
<td>Income Tax Payable</td>
<td>5,000</td>
</tr>
<tr>
<td>Bonds Payable</td>
<td>60,000</td>
</tr>
<tr>
<td>Common Stock</td>
<td>10,000</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>19,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$115,000</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Where gone (or Expenditures or Debits)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$5,000</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>25,000</td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>79,000</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>5,000</td>
</tr>
<tr>
<td>Accrued Expenses</td>
<td>1,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$115,000</strong></td>
</tr>
</tbody>
</table>

Figure 3 - Original Funds Statement

It should be noted that the items which have credit changes appear in the upper section of the statement; the items with debit changes appear in the lower section.
In comparing the original funds statement with the conventional funds statement, two important differences are found. First, the original funds statement includes all of the changes in all items listed on the comparative balance sheets, whereas, the conventional funds statement only shows the changes in the noncurrent assets, noncurrent liabilities, and net worth items which have an effect on working capital. Second, the primary purpose of the conventional funds statement is to show why the working capital increased or decreased for the period. The original funds statement does not show why working capital increased or decreased.

Although Cole's statement is very crude, it might bring to light some significant happenings. For example, if the capital stock account increased $100,000 and the long-term liabilities decreased $100,000, this would suggest a conversion of debt into stock.

It seems that anyone analyzing financial statements would desire more information than that found on comparative balance sheets and the original funds statement. For example, nothing

3Although one might get a good idea of why the working capital increased or decreased from the Cole statement, it is difficult to get an accurate presentation as that found in the conventional statement because more detailed analyses are made of the accounts in the preparation of the conventional statement. For example, Cole's statement shows that the retained earnings account increased $19,000 in the example given. The statement does not show the break-down of the $19,000 increase. Examples presented later in this chapter show additional information which cannot be obtained from the comparative balance sheet by itself.
is presented showing earnings for the year or dividend declarations. The original funds statement merely shows the change in retained earnings in the latter respect. The above comments should in no way leave the impression that Cole did not advocate an earnings statement and an earned surplus analysis.

THE ALL-INCLUSIVE FUNDS STATEMENT

Moyer and Mautz, in their Functional Accounting, present a "statement of resources provided and applied."\(^4\) This statement is similar to the conventional funds statement; however, it does present information which the conventional funds statement does not present. In this study, this statement is called the "all-inclusive funds statement" because it gives this added information; however, it does not explain all of the changes in the items listed on the comparative balance sheets.

Moyer and Mautz state that the balance sheet presents the status of the assets, liabilities, and net worth at a specific date. The income statement presents a summary of the nature and results of transactions affecting net income. Neither the balance sheet nor the income statement shows the nature of the transactions entered into during the period to finance the concern's operations.\(^5\)

---


\(^5\) Ibid., p. 457.
These authors state that management, to plan effectively, should have some record of past financial operations to use as a base or starting point for its planning. To measure the success achieved in meeting the plan, some report of the financial operations during the period under review is needed. The balance sheet and the income statement certainly give much needed information; however, neither of these statements gives anything like a complete report of financial activities, of all resources provided during the period and the uses to which the resources are placed.6

The all-inclusive funds statement shows the following information which is not readily found in the income statement and the balance sheet: the resources provided from operations, the resources provided from other sources, the resources applied to specific purposes, and the net effect of financial operations on working capital.

Net income is not the same as resources provided from operations because certain factors that affect net income (such as depreciation, patent amortization, and depletion) have no effect on resources provided or applied during the period; other transactions as a sale of securities may provide resources considerably greater than their effect on net income. Operations constitute an important source of net assets;

6Ibid., p. 457.
therefore, it is useful to know exactly the amount of re-
sources provided by operations in order to plan for the esti-
mated financial contributions of operations in the future.

A detailed list of various sources of net assets permits
a review of the operations aimed at obtaining new assets in
order to judge their relative importance in the financial
program. A detailed list of the applications of resources
permits a review of the use of resources. This would show
the tendency to channel a majority of resources to any
single use.

The net effect of financial operations on working capital
is shown. A clear explanation is presented to show why the
working capital position has or has not been improved.\(^7\)

From the above comments concerning the "all-inclusive
funds statement" it should be apparent that this statement
resembles the conventional funds statement. In further
analysis of the all-inclusive statement the following differ-
ences appear: the statement is self-balancing; the resources
provided always equal the resources applied. The statement
does not emphasize working capital as specifically as the
conventional statement does. Changes in noncurrent lia-
bilities, noncurrent assets, and net worth items not

\(^7\)Ibid., p. 458. This discussion is paraphrased. The
term, "resources," is used in the paraphrasing as it is used
in the reference. Although the term "resources" usually means
"assets," "resources" is used here loosely and means either
"assets" or "net assets."
affecting working capital are shown to a greater degree than they are on the conventional funds statement where they are not shown at all. For example, stock issued for a building would be shown on the all-inclusive statement and would not be shown on the conventional funds statement. Bonds converted into stock would be shown on the all-inclusive statement and not on the conventional statement. A stock dividend would be shown on the all-inclusive funds statement but not on the conventional statement.8

It was mentioned previously that the all-inclusive funds statement does not show why all of the changes in the comparative balance sheets occurred. For example, this statement does not show arbitrary write-downs and write-ups of assets. If the buildings are written-up during a certain period, the all inclusive statement does not show this write-up.9

Illustration 4 - Preparation of All-inclusive Funds Statement

As other information is needed to prepare the "all-inclusive" funds statement, the additional information is presented below:

8Ibid., p. 477-478.

9Ibid., p. 477.
Y Corporation
Income Statement
For the Year Ended December 31, 1951

Sales $200,000
Cost of Sales $107,000
Depreciation 30,000
*Expenses (other than Depreciation) 35,000 172,000
NET INCOME $ 28,000

*Includes Income Taxes

Y Corporation
Retained Earnings Statement
For the Year Ended December 31, 1951

Retained Earnings, January 1, 1951 $ 50,000
Add: Gain on trade of machine $ 1,000
Net Income 28,000
$ 29,000
Less: Stock Dividend 10,000 19,000
Retained Earnings, December 31, 1951 $ 69,000

Y Corporation
Analysis of Fixed Assets (original cost)
For the Year Ended December 31, 1951

Balance, January 1, 1951 $300,000
Less: Cost of Machine traded 10,000 290,000
Add: Machine Received on trade $ 11,000
Machine purchased for cash 49,000
Machine received for bond issue 50,000 110,000
Balance, December 31, 1951 $400,000
Y Corporation
Analysis of Allowance for Depreciation
For the Year Ended December 31, 1951

Balance, January 1, 1951 $50,000
Less: Amount written-off pertaining to machine traded 9,000
Amount written-off $41,000
Add: Depreciation for year 30,000
Balance, December 31, 1951 $71,000

Book Value of Fixed Assets

<table>
<thead>
<tr>
<th></th>
<th>Jan. 1, 1951</th>
<th>Dec. 31, 1951</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>$300,000</td>
<td>$400,000</td>
</tr>
<tr>
<td>Allowance for Depreciation</td>
<td>$50,000</td>
<td>$71,000</td>
</tr>
<tr>
<td>Book Value</td>
<td>$250,000</td>
<td>$329,000</td>
</tr>
</tbody>
</table>

The entry made for the machine which was traded was as follows:

Fixed Assets $11,000
Allowance for Depreciation 9,000
Fixed Assets $10,000
Cash 9,000
Gain on Trade 1,000

The following "All-Inclusive Funds Statement" is presented from the preceding information and the comparative balance sheets shown for the preparation of the original funds statement.
Y Corporation
Statement of Resources Provided and Applied
For the Year Ended December 31, 1951

RESOURCES PROVIDED
By Operations $ 58,000
By Issuing Bonds 60,000
By Capitalization of Retained
Earnings 10,000
$128,000

RESOURCES APPLIED
To Acquire Fixed Assets $108,000
To Common Stock Dividends 10,000
To Increase Working Capital 10,000
$128,000

Schedule of Working Capital Changes

<table>
<thead>
<tr>
<th>Dec. 31</th>
<th>Dec. 31</th>
<th>Working Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>1951</td>
<td>Increase  Decrease</td>
</tr>
<tr>
<td>Current Assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>$20,000</td>
<td>$25,000</td>
</tr>
<tr>
<td>Accounts Rec. (net)</td>
<td>35,000</td>
<td>60,000</td>
</tr>
<tr>
<td>Inventories</td>
<td>180,000</td>
<td>170,000</td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>10,000</td>
<td>9,000</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>10,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Loans Payable</td>
<td>5,000</td>
<td>15,000</td>
</tr>
<tr>
<td>Income Tax Payable</td>
<td>20,000</td>
<td>25,000</td>
</tr>
<tr>
<td>Accrued Expenses</td>
<td>10,000</td>
<td>9,000</td>
</tr>
<tr>
<td>Increase in Working Capital</td>
<td>36,000</td>
<td>$26,000</td>
</tr>
<tr>
<td></td>
<td>36,000</td>
<td>36,000</td>
</tr>
</tbody>
</table>

Figure 4 - All-inclusive Funds Statement

Notice that the bonds issued for the fixed assets ($50,000) are shown under the caption "resources provided" and that the acquisition of the fixed assets ($50,000) is included in the caption "resources applied." The stock dividend transaction is also included under both captions.
THE PATON FUNDS STATEMENT

Paton and Paton state that the funds statement is not a statement of receipts and disbursements, but that it does attempt to trace business activity for a specified period in terms of impact on cash or cash equivalents. The funds statement is designed to show the relation of the revenue stream to disposable funds and to indicate what disposition has been made of the net income or earnings.  

The funds statement is needed because of the limitations of the balance sheet and the income statement. The income statement is a performance record; it shows the revenues, the deductions, and the net earnings. The balance sheet or position statement reports all recognizable resources, the liabilities, and the stockholders' equity at a given date. Although the income statement does present the earnings, it does not disclose the amount of liquid resources made available and their utilization. The position statement does not trace the course of financing operations during the period or the incidence on resources of earnings currently retained.

The funds statement may well be regarded as an essential supplement to the major statements because it is a means of weaving together the complete record of incoming and outgoing funds. In fact, the funds statement may be entitled to rank as a third main type of financial statement.

---

Funds are working capital (in the Paton statement). Working capital, as defined previously, is the current assets less the current liabilities. Inventories should be included in the fund pool if they are in a very liquid state; however, often inventories are nothing more than a mass of cost factors committed to production. The inclusion of prepaid expenses in the fund pool might leave something to be desired.

Revenues, adjusted for uncollectibles, returns, etcetera, give a reasonable measure of the periodic inflow from ordinary operations. Special items of revenue and gains are included in the inflow of funds if these items are matched by cash or current receivables. Only in rare cases will claims against customers be liquidated by receipt of noncurrent assets or reduction of noncurrent liabilities.

Operating charges absorb current funds in a particular period only to the extent of outlays for that period. These outlays are in the form of actual expenditures of cash (or absorption of other current assets) or in the form of the incurrence of current liabilities. Deductions from revenues such as depreciation, amortization, and depletion do not represent current commitments of funds (ignoring the unimportant case of some absorption of noncurrent assets in the period of acquisition). Charges such as depreciation, depletion, and amortization are true costs because they reflect the assignment to current revenues of appropriate portions of past expenditures; however they do not measure utilization of fund
resources in the period covered by the current funds statement. Accordingly, the revenues should not be reduced by such charges in computing the funds currently made available through receipts (in the sense of receivables as well as cash) from customers. This is important because there sometimes are cases where dividends are disbursed in excess of current net earnings; there might also be a substantial amount of funds available for expansion or retirement of liabilities despite a poor showing in the income statement.

Paton and Paton stress the flow concept. Funds flow into the working capital pool mainly from revenues. Funds flow out of this area mainly because of expenditures.

The proceeds from the sale of fixed assets or other non-current assets increase the working capital by the amount of the proceeds from the sale.

The trade of a noncurrent asset for a noncurrent liability has no effect on funds. The trade of a noncurrent asset for another noncurrent asset has no effect on funds.

All funds received from long-term borrowing or from stock issues should be disclosed as funds inflow. The proceeds from bond and stock issues should be shown net (proceeds less expenditures for services to raise funds). Bond issue costs and financing charges represent long-term assets and should be shown as such on the balance sheet.

\[11\] Ibid., pp. 442-443.
The funds statement should show the application of the proceeds of the issuance of stock and bonds. Bond refunding transactions should be shown. The proceeds of the new issue should be included as an inflow of funds; the retirement of the old issue should be shown as an outgo of funds.

The conversion of bonds into stock should not be shown on the funds statement if the transaction has nothing to do with working capital. The using of available funds to acquire noncurrent assets would represent outgoing funds.

Upward or downward revaluation of noncurrent assets has no effect on funds. However, upward or downward revaluation of current assets has an effect on funds. For example, if marketable securities were written-up during the period under consideration, the amount of the write-up should be shown as a source of funds directly under the revenues. The write-up should be adequately explained.

In comparing the Paton Funds Statement with the conventional statement, the following conclusions are reached: (1) The Paton statement shows why the working capital increased or decreased as does the conventional statement. Both statements are tied strongly to the working capital change. (2) The Paton statement does not show depreciation, amortization, and depletion charges affecting current operations because these have no effect on working capital. The conventional funds statement generally shows these charges as additions to net income under the "funds provided" section.
Figure 5 is an example of the Paton statement:

Y Corporation
Funds Statement
Year Ended December 31, 1951

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue from Sales</td>
<td>$200,000</td>
</tr>
<tr>
<td>Current outlays for expenses and taxes</td>
<td>$142,000</td>
</tr>
<tr>
<td>Funds Available from Operations</td>
<td>$58,000</td>
</tr>
<tr>
<td>Financing:</td>
<td></td>
</tr>
<tr>
<td>Bonds issued during year (proceeds)</td>
<td>$10,000</td>
</tr>
<tr>
<td>Funds Available for expansion and investment</td>
<td>$68,000</td>
</tr>
<tr>
<td>Fixed Assets acquired - amount expended</td>
<td>$58,000</td>
</tr>
<tr>
<td>Increase in net working capital</td>
<td>$10,000</td>
</tr>
</tbody>
</table>

(See schedule as presented on "all-inclusive" statement shown previously)

Figure 5 - Paton Funds Statement

12Ibid., p. 450-452. For a more complete Paton Statement, see the pages listed in this reference. Notice that the Paton statement shows the revenues (sales) and the current outlays. The depreciation, depletion, and amortization are not shown because these items do not affect the working capital. Notice also the various captions on the statement. The other information presented previously for the preparation of the "all-inclusive" statement is necessary for the Paton statement. Notice that the transaction in which bonds ($50,000) were issued for a fixed asset ($50,000) is not included in the Paton statement because the transaction has no effect on working capital.
(3) Neither the conventional nor the Paton statement shows direct exchanges of noncurrent assets for other noncurrent assets, retirement of noncurrent liabilities by noncurrent assets, conversion of noncurrent liabilities for stock, write-ups and write-downs of noncurrent assets, or any other changes occurring during the period which have no effect on working capital. (4) The Paton Statement is divided into the following main categories: "Funds available from operations, disposition of noncurrent assets, and decrease in working capital (if this occurred),\(^\text{13}\) "balance of funds after dividends:" "financing;" "funds available for expansion and investment;" and "increase in working capital." The conventional statement is divided into two main sections; "sources," and "uses."

The Paton Funds statement has the following advantages over the conventional statement: (1) It shows the full flow of items into and out of the working capital area. By doing this it does not give the reader the idea that depreciation, depletion, and amortization of noncurrent assets "provide funds." (2) It is divided into the various categories so that the reader can receive a more comprehensive picture of financial happenings of the business unit.

\(^{13}\)It is recognized by Paton and Paton that there can not be both an increase and decrease in working capital during the same period.
The Paton Funds statement has the following disadvantages over the conventional statement: (1) It is more complicated. (2) It does not show a net income figure; the reader might have difficulty in tying the "funds available from operations" figure to the net income in the income statement.

THE NET QUICK ASSET FUNDS STATEMENT

The net quick asset funds statement explains why the net quick assets of a business unit increased or decreased for a certain period. The net quick assets are considered cash, marketable securities, accounts receivable, notes receivable (current), less the current liabilities. The main item (besides the prepaid expenses) which is left out of the current asset category is the inventory.14

Although others have written about the net quick asset funds statement,15 Professor Moonitz has done a very complete job; therefore, his statement is examined in this study.

Moonitz states that neither the balance sheet nor the income statement taken alone will show the financial flow for a relative short period of time. A separate statement of funds is ordinarily desirable for a complete reporting.16

Basically the funds statement should show the funds coming into the business unit and the funds leaving the unit. This involves external transactions; internal transactions such as transfers, amortisation, and depreciation do not constitute part of the funds flow.

The funds statement is being used more now than in the past because of the recent inflationary movement associated with a high level of business activity and high tax rates. This inflationary movement has posed financing problems on a scale so large as to constitute new problems in financing. The funds statement shows why a net profit of a million dollars is not identical with an increase in funds of the same amount. The rapid changes of prices in an inflationary period make comparisons of income statements difficult; the funds analysis helps by submitting a more elementary, less sophisticated type statement in addition to the income calculation. Another use of the funds statement could be compared with the economists' "distributive shares" approach in the output of a concern or an industry. For example, now, the economist is interested, according to Moonitz, in "take-home pay" of wage earners, suppliers, creditors, stockholders, and others. A statement of funds is better adapted to the dissemination of this type of information than the income statement with its highly abstract, elaborate cost allocations and estimates.
The conventional funds statement has one very good characteristic. It contains a definition of funds; in this statement the term, "funds," means working capital. By defining the term, "funds," it is possible to show in the conventional statement all of the transactions that have an effect on the working capital. The other transactions are eliminated from the statement. For quite some time, no one (not even the accountants), knew what the term, "funds," meant, and there are still differences of opinion.

Moonitz states that the working capital definition of funds has certain disadvantages. He shows that some companies (for example the American Phenolic Corporation) present two funds statements, the conventional statement and a cash flow statement. This is a symptom which shows that more information is sometimes needed which is not shown on the conventional statement. 17

The cash flow statement is probably overly-narrow. A better balance would be attained if the term, "funds," were defined somewhere between cash and working capital. A useful mid-point is "net money assets available for disposition." 18

The term, "Funds," under this concept, would include cash on

17 Ibid., p. 379.

18 Ibid., p. 379.
hand and in banks, marketable securities, and current receivables less current liabilities which will be paid by quick assets in the near future. Where bank financing is important, bank loans are excluded from the category, "funds," and treated as a source or application. 19

It was mentioned previously that the "net quick assets" concept of the term, "funds," omits the inventories from funds. Inventories are considered an application of funds when debts are incurred to move them from the materials stage through process and into the finished goods stage. Inventories are considered a source of funds when they are sold to customers.

When inventories are almost equivalent to receivables, as for example inventories of precious metals which are carried at selling price, they are included in the fund category.

Whether the term, "funds," means working capital or "net money assets available for disposition," certain financial transactions which should be included in the statement will be omitted. For example, it was mentioned previously in this study, that the exchange of land for a long term liability would not be shown on the conventional funds statement. These items, which concern financing, should be shown even though

19Ibid., p. 379.
they have no effect on funds. This concept goes along with the concept mentioned previously that all external transactions should be shown on the funds statement.  

The purpose of the funds statement is not to tell more about the income-generating and income measuring process, but to disclose data concerning the financial management of the business enterprise.

The "net quick asset" funds statement, devised by Moonitz follows:

<table>
<thead>
<tr>
<th>Y Corporation</th>
<th>Funds Statement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>For the Year Ended December 31, 1951</td>
</tr>
</tbody>
</table>

Funds, January 1, 1951 $15,000

Funds were derived from:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Long Term loans</td>
<td>$60,000</td>
</tr>
<tr>
<td>Short Term loans</td>
<td>20,000</td>
</tr>
<tr>
<td>Sales to customers (includes reduction in inventory)</td>
<td>210,000</td>
</tr>
</tbody>
</table>

Funds were used to:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Pay short term loans</td>
<td>$10,000</td>
</tr>
<tr>
<td>Cover expenses</td>
<td>34,000</td>
</tr>
<tr>
<td>Cover Cost of Sales</td>
<td>107,000</td>
</tr>
<tr>
<td>Purchase Fixed Assets</td>
<td>108,000</td>
</tr>
</tbody>
</table>

Funds, December 31, 1951 $46,000

---


21 *Ibid.*, p. 384. For a more complete "net quick asset" statement see the page listed in this reference. Notice that the above statement includes the issuance of bonds $50,000 in the "funds derived" section, and the fixed asset $50,000, in the "funds were used" section, even though the bonds were issued directly for the fixed asset and the transaction had no effect on funds.
Schedule of Net Quick Assets excluding Bank Loans
(short term loans)

<table>
<thead>
<tr>
<th></th>
<th>Dec. 31 1950</th>
<th>Dec. 31 1951</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Quick Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>$20,000</td>
<td>$25,000</td>
</tr>
<tr>
<td>Accounts Receivable (net)</td>
<td>$35,000</td>
<td>$60,000</td>
</tr>
<tr>
<td><strong>Total Quick Assets</strong></td>
<td>$55,000</td>
<td>$85,000</td>
</tr>
<tr>
<td><strong>Current Liabilities (excluding short term loans)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td>$10,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>Income Tax Payable</td>
<td>20,000</td>
<td>25,000</td>
</tr>
<tr>
<td>Accrued Expenses</td>
<td>$10,000</td>
<td>$9,000</td>
</tr>
<tr>
<td><strong>Total Current Liabilities (excluding short term loans)</strong></td>
<td>$39,000</td>
<td></td>
</tr>
<tr>
<td><strong>Net Quick Assets Excluding Short Term Loans</strong></td>
<td>$15,000</td>
<td>$46,000</td>
</tr>
</tbody>
</table>

Figure 6 - Net Quick Asset Funds Statement

Illustration 5 - Preparation of Net Quick Asset Funds Statement

In addition to the previous information presented for the preparation of the Paton statement, the following calculations are necessary for the "net quick asset" fund statement:

**Analysis of Bank Loans**
For the Year Ended December 31, 1951

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance, January 1, 1951</td>
<td>$5,000</td>
<td></td>
</tr>
<tr>
<td>Add: Additional loans during 1951</td>
<td>20,000</td>
<td></td>
</tr>
<tr>
<td>Less: Loans paid during 1951</td>
<td></td>
<td>$25,000</td>
</tr>
<tr>
<td>Balance, December 31, 1951</td>
<td></td>
<td>$15,000</td>
</tr>
</tbody>
</table>

**Sales to Customers**

| Sales on account                  | $200,000    |             |
| Reduction in Inventory            | 10,000      |             |
| Sales and Reduction in Inventory  |             | $210,000    |

**Funds to Cover Expenses**

| Expenses (on accrued Basis, except depreciation) | $35,000     |
| Less: decrease in prepaid expenses            | 1,000       |
| Funds to cover expenses                        | $34,000     |
The following comments pertain to the preceding "net quick asset" funds statement devised by Moonitz. Although the term, "fund," defined by Moonitz, means briefly, quick assets less current liabilities except bank loans; his statement shows other noncurrent assets increasing the "fund" balance. For example, a building donated to the firm would be shown as an increase in "funds." This is inconsistent with the definition of "funds." The building, in this example, would increase assets, but would not increase the net quick assets. Some other name attached to this statement might correct part of the inconsistency.

The net quick asset funds statement does have advantages over the conventional statement. It shows short-term financing transactions, it shows the full flow of funds into and out of the "net quick asset fund" section, it shows exchanges of long-term assets for long-term liabilities and other exchanges which have no effect on funds as defined for this statement. This last advantage, as mentioned above, seems to show an inconsistency in the statement, although the information given is certainly pertinent.

THE CASH FLOW STATEMENT

The cash flow statement is included in the "funds" category because some people consider that the term, "funds," means "cash." This statement shows why the cash increased or decreased during a certain period. The statement, then, shows
only the changes in the noncash accounts which have an effect on cash. All of the other changes on the comparative balance sheets are eliminated.²²

One source of cash coming into the unit is the sales and payments on account. This inflow of cash is found by adding current sales to the beginning accounts receivable balance and deducting the ending amount in the accounts receivable. The allowance for bad debt change has no effect on the above computation if this change occurred to arrive at the bad debt charge on the income statement and to arrive at net realizable value of accounts receivable on the balance sheet. However, if an account is written-off during the period, the amount written-off will have to be added to the accounts receivable to show correctly the cash provided by collections on account and sales.

Other cash sources are found by analyzing all other non-cash accounts. For example, cash proceeds from bond issues are determined by analyzing the fixed liability accounts and the bond transactions. The same method would be used to find the cash coming into the unit from the sale of fixed assets, the issuance of stock, and other sources.

One of the main reasons for cash outgo is the disbursement of cash for purchases. This is found by adding the

cost of sales to the ending inventory, deducting the beginning inventory, and adjusting for the change in accounts payable.

The cash going out for expenses is found by adding the expenses listed on the income statement (excluding depreciation, depletion, and amortization) to the prepaid expenses at the end of the period and deducting the prepaid expenses at the beginning of the period. This amount is also adjusted by the accrued expenses in the comparative balance sheets. If the accrued expenses increased for the period, the amount of the increase is deducted from cash applied for expenses. If the accrued expenses on the comparative balance sheets decreased, this amount is added to the cash applied for expenses.

Other cash outgo items are found by analyzing the changes in the noncash accounts which occurred during the period covered by the statement.

It seems that, with a punched card system of accounting or with an accounting system using high-speed computers, the cash flow statement could be prepared as easily by analyzing the cash account itself. For example, all punched cards which have an effect on cash, could be sorted into any desired order; the statement could then be prepared from the cards by running the cards through the tabulating machine. Many accountants would probably state that this process would give a statement of cash receipts and disbursements; however, a statement of
receipts and disbursements, compiled into various sections, should show approximately the same information that a cash flow statement shows, and the cash receipts and disbursement statement would probably show this information more accurately because no assumptions would need to be made to prepare it. A company using cash receipts and disbursements journals could also prepare a cash receipts and cash disbursement statement very easily from the journals.

In comparing the cash flow statement with the conventional funds statement the following conclusions appear: The conventional funds statement explains why working capital increased or decreased during a certain period; the cash flow statement explains why cash increased or decreased. The cash flow statement would show short-term loans and short-term loan payments; the conventional funds statement would not show these transactions. The conventional funds statement is based on the accrual method of accounting; the cash flow statement, of course, is based on the cash method. The declaration of a cash dividend at the end of a period is shown on the conventional funds statement; the dividend is not shown on the cash flow statement until it is paid.

The proceeds from the issuance of stock, bonds, and long-term notes would be shown on both statements. The proceeds from the sale of a noncurrent asset would be shown on both statements. Transactions involving noncurrent assets,
liabilities, and net worth items, having no effect on working capital would not be shown on either of these statements. Current items having no effect on working capital, such as bank loans, payment of short-term liabilities such as loans, accounts payable, income taxes payable, and other short-term items would not be shown on the conventional funds statement but would be shown on the cash flow statement if they had an effect on cash.

Illustration 6 - Preparation of Cash Flow Statement

Additional analyses are needed to prepare the cash flow statement. These analyses follow:

Analyses of Cash Payments for Merchandise
For the Year Ended December 31, 1951

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Payable, January 1, 1951</td>
<td>$10,000</td>
</tr>
<tr>
<td>Add: Cost of Sales (per Income Statement)</td>
<td>107,000</td>
</tr>
<tr>
<td>Deduct: Accounts Payable, Dec. 31, 1951</td>
<td>5,000</td>
</tr>
<tr>
<td>Deduct: Decrease in Inventories</td>
<td>10,000</td>
</tr>
<tr>
<td>Cash payments for Merchandise</td>
<td>102,000</td>
</tr>
</tbody>
</table>

Analyses of Cash Payments for all other Expenses
For the Year Ended December 31, 1951

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Tax Payable, January 1, 1951</td>
<td>$20,000</td>
</tr>
<tr>
<td>Accrued Expenses, January 1, 1951</td>
<td></td>
</tr>
<tr>
<td>Add: Expenses per Income Statement</td>
<td></td>
</tr>
<tr>
<td>Less: Income Tax Payable, Dec. 31, 1951</td>
<td>$25,000</td>
</tr>
<tr>
<td>Accrued Expenses, Dec. 31, 1951</td>
<td>9,000</td>
</tr>
<tr>
<td>Less: Decrease in Prepaid Expenses</td>
<td></td>
</tr>
<tr>
<td>Cash Paid for Expenses</td>
<td>$30,000</td>
</tr>
</tbody>
</table>
Analyses of Bank Loans
For the Year Ended December 31, 1951

Balance, January 1, 1951 $ 5,000
Add: Additional Loans during 1951 $20,000
Less: Loans Paid during 1951 $10,000
Balance, December 31, 1951 $15,000

Analyses of Cash Received from Cash Sales and Payments on Account
For the Year Ended December 31, 1951

Accounts Receivable, January 1, 1951 $ 35,000
Sales (per Income Statement) $200,000
Less: Accounts Receivable, Dec. 31, 1951 60,000
Cash Received $175,000

The following cash flow statement is prepared from the preceding analyses.
Y Corporation  
Cash Flow Statement  
For the Year Ended December 31, 1951

<table>
<thead>
<tr>
<th>Cash was increased by:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales and Customer Payments</td>
<td>$175,000</td>
</tr>
<tr>
<td>Issuing Bonds</td>
<td>10,000</td>
</tr>
<tr>
<td>Short term loans</td>
<td>20,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$205,000</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cash was decreased by:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Payments for merchandise</td>
<td>$102,000</td>
</tr>
<tr>
<td>Payments for expenses</td>
<td>30,000</td>
</tr>
<tr>
<td>Payments for new machines</td>
<td>58,000</td>
</tr>
<tr>
<td>Payments to retire short term loans</td>
<td>10,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>200,000</strong></td>
</tr>
</tbody>
</table>

**Net Increase in Cash**  
**$5,000**

**Figure 7 - Cash Flow Statement**

**THE CONVENTIONAL FUNDS STATEMENT**

To give the reader a better idea of how the other funds statements differ from the conventional funds statement, an example of the conventional statement follows.
Y Corporation
Statement of Funds
For the Year Ended December 31, 1951

Funds were provided by:

Operations:
   Profit per income statement $28,000
   Add: Depreciation 30,000 $58,000
   Issuance of Bonds 10,000 $68,000

Funds were applied to:
   Acquire new machine (trade) $ 9,000
   Acquire other machine (cash) 49,000 $58,000
   Increase in working capital $10,000

Schedule showing changes in Working Capital items.
(Same schedule as is shown on the "all-inclusive" statement)

Figure 8 - Conventional Funds Statement

Chapter III contained a discussion of the conventional funds statement. It is prepared, basically, by using the same information which is used for the preparation of the Paton statement; consequently the conventional statement contains approximately the same information that is contained in the Paton statement.

Summary

In the following analysis, one can see in which funds statement the information listed at the left appears.
<table>
<thead>
<tr>
<th>Information</th>
<th>Conventional</th>
<th>Original</th>
<th>All inclusive</th>
<th>Paton's</th>
<th>Net Quick Asset (Excluding short-term notes)</th>
<th>Cash Flow</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds from bond and stock issuance</td>
<td>x</td>
<td></td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Net proceeds from sale of noncurrent assets</td>
<td>x</td>
<td></td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Proceeds from issuance of short-term notes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Net income adjusted for depreciation, depletion, etc.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Sales (accrual basis)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Expenses (accrual basis - excluding non-fund charges)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td>x</td>
</tr>
</tbody>
</table>

23 Although much of the listed information may be found in the original funds statement, the information is presented in a crude way and is not presented specifically as in the other statements.
<table>
<thead>
<tr>
<th>Information</th>
<th>Conventional</th>
<th>Original</th>
<th>All inclusive</th>
<th>Paton's</th>
<th>Net Quick Asset (Excluding short-term notes)</th>
<th>Cash Flow</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gifts (noncurrent)</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>24</td>
</tr>
<tr>
<td>Gifts (marketable securities)</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Gifts - Cash</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Write-up or write-down of marketable securities</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Write-up or write-down of noncurrent assets</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash applied for retirement of noncurrent liability or applied for purchase of noncurrent asset</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
</tbody>
</table>

24 The including of gifts of noncurrent assets as an increase to the quick asset fund category is inconsistent with the definition of the term, "funds," used in the quick asset fund statement. However, Moonitz includes the gifts of noncurrent assets in his statement because these gifts represent resources coming into the business unit from an external source.
<table>
<thead>
<tr>
<th>Information</th>
<th>Conventional</th>
<th>Original</th>
<th>All inclusive</th>
<th>Paton's</th>
<th>Net Quick Asset (Excluding short term notes)</th>
<th>Cash Flow</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash applied to retire short term notes</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td>x (cash)</td>
<td></td>
</tr>
<tr>
<td>Cash Dividend declarations</td>
<td>x</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividend cash payments</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Loss of noncurrent assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loss of cash and/or marketable securities</td>
<td>x</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contains all changes found between comparative balance sheets</td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Conversion of noncurrent assets for other non-current assets</td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Application of noncurrent asset to retire long-term liability</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Conversion of long-term liability for another long term liability or for capital stock</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Information</td>
<td>Conventional</td>
<td>Original</td>
<td>All inclusive</td>
<td>Paton's</td>
<td>Net Quick Asset (Excluding short term notes)</td>
<td>Cash Flow</td>
</tr>
<tr>
<td>-----------------------------------------------------------------------------</td>
<td>--------------</td>
<td>----------</td>
<td>--------------</td>
<td>---------</td>
<td>---------------------------------------------</td>
<td>-----------</td>
</tr>
<tr>
<td>Stock dividend</td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prepared on accrual basis</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Prepared on cash basis</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Includes schedule of changes in items making up working capital</td>
<td></td>
<td>x</td>
<td></td>
<td>x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Includes schedule of net quick assets, excluding short term notes</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


CHAPTER V
CURRENT PRACTICE

It is the purpose of this chapter to show whether or not the funds statement is increasing in use, to show how it is used, to show the most common forms of the statement in use, and to show what meaning the term, "funds," has in practice.

To find the above information questionnaires were distributed at a meeting of the Society of Louisiana Certified Public Accountants; interviews were carried on with an executive of a large oil refinery, with chief loan officers of local banks, and with local certified public accountants; a study was made of the annual stockholders' reports of 100 companies; and data from other studies were examined.

THE INCLUSION OF FUND STATEMENTS IN AUDIT REPORTS

The Kempner Study

A survey was made concerning the fund statement practices of the national and large local certified public accounting offices located throughout the country.\(^1\) The conclusions of this study show that almost fifty per cent of the certified

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\(^1\)Jack J. Kempner, "Funds Statement Practices of Certified Public Accounting Firms," The Accounting Review. XXXII (January, 1957), 71-82. The survey was made by sending questionnaires to Certified Public Accountants listed in the 1954-55 membership lists of the American Institute of Accountants.
public accounting firms included a funds statement in less than one third of the reports ten years ago. Today approximately fifty per cent of the firms include a funds statement in two out of three audit reports. If this trend continues, the fund statement may soon appear in the great majority of long form reports prepared by certified public accountants. ²

The survey, mentioned in the above paragraph, also shows that the titles, "Statement of sources and application of funds," and "statement of application of funds," were the most widely used during the period covered by the survey. ³

The meaning of the term, "funds," is "working capital" in approximately 75 per cent of the replies included in the above survey. The conclusion reached is that there seems little doubt that the emphasis on changes in working capital is preferred by the majority of practicing accountants. ⁴

Findings At the Society of Louisiana Certified Public Accountants Meeting

Fifty questionnaires were distributed to practicing certified public accountants of Louisiana at the yearly meeting of the Society of Louisiana Certified Public Accountants held in Lafayette, Louisiana, on May 23 - 24, 1957. Thirty six of the questionnaires were returned, representing seventy-two per cent of the sample. A copy of the questionnaire is presented in Appendix A.

²Ibid., p. 73.
³Ibid., p. 76.
⁴Ibid., p. 78.
According to the leaders of the Society of Louisiana Certified Public Accountants, the membership attending this meeting mentioned above did not come predominately from any one firm. In other words, the members of one or two large firms did not throw a bias into the sample. There were firms which had more than one representative. However, as the larger firms probably had more than one representative, and as these larger firms evidently have a greater firm volume of work, there should be an appropriate weighting built into the sample.

The first question on the questionnaire is as follows:

Do you include a funds statement (also called statement of Sources and application of funds and various other titles) in your long form reports:

- Occasionally? 
- Never?
- In every report or nearly in every report?

The results of the first question are as follows:

- Occasionally: 14 members, 39%
- In every report or nearly in every report: 22 members, 61%
- Never: 36 members, 100%

The above results show that approximately 39 per cent of the members answering the questionnaire include the statement of funds occasionally; approximately 61 per cent include the
statement of funds in every report or nearly in every report (long form report). It was beyond the scope of this questionnaire to attempt to determine what percentage of audit reports were long form reports.

The second question on the questionnaire is as follows:

Did you include a funds statement (in your long form reports) 10 years ago:

_____ Occasionally?  ____ Never?

_____ In every report or nearly in every report?

The results of the second question are as follows:

Occasionally 13 members 52%

In every report or nearly in every report 8 members 32%

Never 4 members 16%

25 members 100%

The results pertaining to question number 2 show that approximately 52 per cent of the members answering the question included the funds statement occasionally in their long form audit reports 10 years ago; 32 per cent of the members included the funds statement in every report or in nearly every report 10 years ago; and approximately 16 per cent did not include the funds statement in the long form report 10 years ago.

Seven members indicated that they were not in practice 10 years ago. Four members did not fill in this question. It is assumed that all of these members (11) were not in practice 10 years ago.
The following tabulation concerning members who were in practice ten years ago shows a comparison of the practice of these members at the present time with the practice ten years ago:

<table>
<thead>
<tr>
<th></th>
<th>Present Time Members</th>
<th>Present Time Per Cent</th>
<th>Ten Years Ago Members</th>
<th>Ten Years Ago Per Cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Occasionally</td>
<td>10</td>
<td>40</td>
<td>13</td>
<td>52</td>
</tr>
<tr>
<td>In every report or nearly in every report</td>
<td>15</td>
<td>60</td>
<td>8</td>
<td>32</td>
</tr>
<tr>
<td>Never</td>
<td>0</td>
<td>0</td>
<td>4</td>
<td>16</td>
</tr>
<tr>
<td></td>
<td>25</td>
<td>100</td>
<td>25</td>
<td>100</td>
</tr>
</tbody>
</table>

The tabulation shows that 10 members occasionally include the funds statement in their long form reports at the present time, while 13 members occasionally included the funds statements in their long form reports ten years ago. Fifteen members include the funds statement in every report or nearly every report at the present time, whereas eight members included the statement in every report or nearly in every report 10 years ago. Four members, who did not include the statement ten years ago, do include it today.

Of the eleven newer members who were not in practice ten years ago, seven include the funds statement in every or nearly in every report (64%), while four include the statement occasionally (36%).

The preceding tabulations of the answers to questions numbered one and two of the questionnaire show that the funds
statement is included in Louisiana certified public accountants' long form audit reports more at the present time than it was ten years ago.

The third question on the questionnaire is as follows:

What title do you place on your funds statement?

The results of the third question are as follows:

<table>
<thead>
<tr>
<th>Title</th>
<th>Number of members</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statement of Sources and Application of Funds</td>
<td>17</td>
</tr>
<tr>
<td>Statement of Application of Funds</td>
<td>10</td>
</tr>
<tr>
<td>Statement of Changes in Working Capital</td>
<td>2</td>
</tr>
<tr>
<td>Statement of Sources and Disposition of Funds</td>
<td>5</td>
</tr>
<tr>
<td>Statement of Funds Derived and Applied</td>
<td>1</td>
</tr>
<tr>
<td>Funds Available and Used</td>
<td>2</td>
</tr>
<tr>
<td>Statement of Sources of Funds which became available to business during the period and the use made of these funds</td>
<td>1</td>
</tr>
<tr>
<td>Where Got - Where Gone Statement</td>
<td>1</td>
</tr>
<tr>
<td>Statement of Funds Provided and Their Application</td>
<td>1</td>
</tr>
</tbody>
</table>

It should be noted that 37 titles out of the 40 contain the term, "funds." Three out of the 40 titles do not include the term, "funds."

6 This total (40) differs from the number of questionnaires returned (36) because some members mentioned more than one title for the statement.
The sample shows that the predominant titles used by the certified public accountants polled are "Statement of Sources and Application of Funds," and "Statement of Application of Funds."

The fourth question on the questionnaire is as follows:

In your opinion, what is the meaning of the word, "funds," in the funds statement?

The results of the fourth question are as follows:

<table>
<thead>
<tr>
<th>Meaning</th>
<th>Number of members</th>
</tr>
</thead>
<tbody>
<tr>
<td>Working Capital</td>
<td>14</td>
</tr>
<tr>
<td>Net Quick Assets</td>
<td>6</td>
</tr>
<tr>
<td>All Balance Sheet Items</td>
<td>9</td>
</tr>
<tr>
<td>Cash</td>
<td>5</td>
</tr>
<tr>
<td>All Balance Sheet Items considering amount of net working capital as one item</td>
<td>1</td>
</tr>
<tr>
<td>Other (this answer is withheld because the reader evidently misunderstood the question)</td>
<td>[\frac{1}{36}]</td>
</tr>
</tbody>
</table>

Question number four, to be answered effectively, would require more explanation of the various meanings presented on the questionnaire; however, the "working capital" meaning, which is the most common meaning in accounting literature, predominates in this sample.

USES OF FUND STATEMENTS

Kempner found in his survey that almost 40 per cent of the certified public accounting firms replying to his questionnaire believed that the change in the working capital position
was the most valuable function of the funds statement. Approximately 32 per cent of the firms considered the sources from which the funds were obtained to be the most important function.\(^7\)

Anton made a survey of 500 United States and Canadian corporations.\(^8\) His study was concerned primarily with the use of the funds statement as an internal report to management. He found that the larger corporations used the statement to a greater degree than the smaller corporations. One third of all corporations which adopted the funds statement did so in the last ten years; however, approximately 50 per cent of the smaller corporations adopted the funds statement within the last 10 years.\(^9\)

Anton found that only 50 per cent of the users consider the term, "funds," as meaning "working capital." Almost thirty per cent of the users consider the meaning to be "cash," or "cash equivalent." Approximately 38 per cent of the companies, included in Anton's study, exclude inventories from the funds category.

Although Anton was primarily concerned with the uses of the statement internally by management, he also found that many more companies are including the statement in the annual reports

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\(^7\) Kempner, op. cit., p. 74.


\(^9\) Ibid., p. 623.
to stockholders. The reason for the inclusion is that management has felt an increasing pressure to account for its reported profits and retained earnings, and there has been a need to report sufficiently for replacement of fixed assets.

According to Anton, the prime objectives of the funds statement are to help management control finances and to report on finances. The funds statement is a planning device. It is also an accountability statement.\(^{10}\)

Horngren\(^{11}\) made a study of the existing literature on investment analysis; he also scrutinized 123 written analytical reports, and interviewed 51 analysts in trust departments of banks, investment counseling firms, underwriting houses, insurance companies, investment trusts, brokerage houses, and investment research firms in New York City and Chicago.

The conclusion of the above study is that the funds statement deserves much more attention than it has received in the past. The funds statement should be widely recognized as a valuable financial report. Such a statement, prepared with full cognizance of its uses and limitations, might help in solving some difficult analytical problems. It might

\(^{10}\)Ibid., pp. 620-625.

serve better than price level adjustments to fill the needs of those who use the data in financial reports.

Horngren quotes Carman G. Blough as follows:

Probably no great percentage of those who read financial statements can make an intelligent forecast irrespective of how complete the data may be, but there are enough who can and they have sufficient stake in corporate securities so that the data should be published.\(^{12}\)

Decision-making or decision-influencing is the ultimate goal of the analyst. The analyst compares economic conditions now with past economic conditions; he compares characteristics of various industries and relates industries to their respective economic environments; and he compares the current and past performances of various companies within the industries.

If funds statements are not included in the corporate annual reports analysts either have to make their own funds statements or have to analyze comparative balance sheets in such a way that their analyses amount to about the same thing as flow analyses.

Analysts try to estimate the future additions to sales and profits which probably will flow from current and planned expansion. The analysts' estimates of future performance are based on information concerning past relationships between

\(^{12}\)Ibid., p. 56.
capital spending and sales or profit increases. Therefore, the analysts discuss the probable impact of capital expenditures on financial position, earnings, and dividends. To use the information concerning current and planned expansion, of course, the analysts must have a knowledge of the types of new products or processes which will develop.

Analysts attempt to determine operating policies of management by concentrating on the capital expenditure approach. A company which maintains and enhances its competitive position is desired. Capital spending is considered as one of the best reflections of the intention of management to develop better products, to diversify production, and to improve cost control. Management is judged by its recent performance (5 to 7 years) concerning capital expenditures. Such performance is determined primarily by the relationship of sales, earnings, and dividends to capital expenditures.13

According to Horngren, most analysts do not wish to have the income statement adjusted by the use of index numbers. Price level changes do not appear overwhelming to the analysts because the analysts use the "fund flow" approach. The "fund flow" approach is as follows: revenue from customers is considered total current dollars from operations. Current expenses are considered outlays in current dollars. After meeting the current expenses, the difference is considered

13Ibid., p. 56.
"what’s left" of revenue. A part (depreciation) of "what's left" is thought to be "recovery" of past fixed asset outlays and is (or should be) used to pay off the long-term debt which arose from prior expenditures or applied to maintain or enhance physical capacity. The final difference (residual) might be used in numerous ways, such as for dividends, plant expansion, more working capital, and payment of long-term debts.

Horngren concludes by stating that the funds statement ranks with the income statement and balance sheet in importance and usefulness. He states that the funds statement should be studied more by the accountants and made to fit into the entity theory of accounting. He thinks that the funds statement, if presented adequately and more consistently, may someday de-emphasize the income statement. This de-emphasis is necessary to at least some degree because many people place too much emphasis on the "net income" figure of the income statement. He likes the statement of Paton because it does not give the impression that depreciation "provides funds."15

Interviews With Local Certified Public Accounting Firm Members

Interviews were held with the members of eight local certified public accounting firms. The size of this sample is, of course, too small to make any general conclusions; however many interesting, important facts were derived.

14 Ibid., p. 58.
15 Ibid., p. 59.
Three of the larger local firms include the statement of funds in nearly every long form audit report. One firm includes the statement in some reports, and four firms include the statement very seldom.

The primary purpose of these interviews was to determine how the statement of funds is used.

Four of the above firms include the statement of funds in the reports "to show clients what happened to the profits." The clients wonder why the working capital decreased when the profits increased. One member stated that the clients want to know "what happened to their money." Clients can't understand how the cash decreases greatly when the income statement shows a profit. Of course, in the latter instance, the cash flow statement would help to explain why the cash decreased. The income statement, of course, shows how the profit occurred.

One member stated that his firm includes the funds statement mainly to show the long-term financing transactions. He uses the funds statement in conjunction with the capital budget, and he stated that the statement presents somewhat of an analysis of the "cash picture" of the business unit. He realized that the conventional funds statement shows the changes of the noncurrent accounts affecting working capital.

The member of one of the firms included in the study stated that he includes a statement of funds in the reports
of his clients who have trouble understanding the balance sheet.

Another member of a certified public accounting firm includes the statement of funds in his reports only if the client requests it or if he, the member, thinks it necessary for a better understanding of the financial statements by the client.

One firm includes the statement of funds to show the changes in the noncurrent accounts which affect working capital. Prior to 1954, this firm very seldom included the funds statement in its long form reports; now it includes the statement in every long form report unless the client specifies to the contrary. This firm intends to include a cash flow statement in the reports of savings and loan companies because these companies have no merchandise inventories and cash is one of the predominant items in the current asset sections of these balance sheets.

The firms mentioned in this section evidently have clients who generally are classified as smaller business units. The funds statement probably helps the managers of these units to learn more about the financial transactions of the businesses and how to interpret the financial statements. The funds statement should definitely help the accounting personnel explain the happenings of the business unit to the management.
Interviews With Chief Loan Officers of Local Banks

Interviews were carried on with the loan officers of three of the largest banks in Baton Rouge. This sample is too small to make any specific conclusions; however, as before, many important facts were disclosed.

The first banker interviewed stated that he did not require a funds statement from the borrower. He said that quite a few reports contain the statement, and that the statement is helpful to the banker. He is very much interested in the working capital position of the business unit under investigation, and he thinks that the statement of funds helps him analyze the working capital position.

The second banker stated that the working capital position of a business unit is very important and that he appreciates the inclusion of the funds statement in the reports submitted to him, but that he cannot require the statement from his clients. This banker uses the statement, if available, to analyze the working capital in an attempt to determine the future needs of the business unit under review.

The third banker interviewed stated that it is the purpose of the bank to finance business units for short periods of time. The bank is, so to speak, a partner with the business unit until the unit builds up sufficient working capital. After sufficient working capital is obtained, the unit no longer needs help except in special circumstances.
This banker stated that many reports do not include enough information; he recognizes the need for the statement of funds. He stated that more of these statements should be included in the reports so that the bankers "would not have to dig so much." This banker wants to know why the working capital decreased or increased during a certain period.

All of the bankers mentioned above are interested in the cash position of the borrowers.

**Interview With a Member of the Management of a Large Refinery**

The person interviewed for this part of the study was chosen because he is a certified public accountant and because he is a member of the management of a large oil refinery. The purpose of this interview was to determine how the funds statement is used.

At the end of the company's fiscal year, the funds statement is taken (along with other reports) to the New York office of the parent company. It (the funds statement) is used to show how the expansion of the company was financed and is used with the capital budget to help determine what should be expended during the next year.

The executive mentioned an interesting point in regards to the decrease of working capital. He stated that the Baton Rouge Company had decreased working capital by decreasing the amount of inventories on hand. This decrease in inventories was accomplished by using a high speed computer. The computer keeps perpetual inventory records accurately and keeps
them up-to-date; management knows the inventory position at least weekly. The computers are programmed to order goods when the inventory drops to a certain level. By keeping the inventory records in this way, a lower level of inventory is needed. The company purchases from suppliers who ship promptly at given requests. By keeping a low, adequate inventory, the net assets remaining in the business unit from operations may be invested in plant, used in some other phase of the business, or returned to the stockholders. The company takes all cash discounts, and the payables are kept open as long as possible.

A STUDY OF ANNUAL REPORTS TO STOCKHOLDERS

One hundred annual reports to stockholders were studied to determine how often the funds statement is included in annual reports; to determine what type funds statement is used; and to determine what meanings are associated with the term, "funds." The one hundred annual stockholders' reports were found in the Louisiana State University College of Commerce Library. All of these reports were for corporations with 1956 calendar years or with fiscal years ending sometime during 1956 except for seven reports. The seven reports had years ending sometime in 1954 or 1955.

The results of the study show that 22 companies (22%) out of the sample of 100 include a funds statement in their

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16A list of the companies studied is included in Appendix B.
annual reports. Accounting Trends and Techniques in Published Corporate Annual Reports, which contains the results of a study of 600 companies, shows that 22 per cent, or 133 companies out of the 600 included a funds statement in 1955. Therefore, the sample of one hundred used in this study gives approximately the same result as the sample used in Accounting Trends and Techniques. It should be noted that the companies studied in both of these samples are large companies who send annual reports to their stockholders.

The following tabulation shows the titles given to the 22 funds statements found in this sample of 100 companies:

<table>
<thead>
<tr>
<th>Title</th>
<th>Number of companies</th>
<th>Per cent (approximate)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Summary of Working Capital Changes, or some similar title</td>
<td>7</td>
<td>33</td>
</tr>
<tr>
<td>Source and Application of Funds</td>
<td>3</td>
<td>14</td>
</tr>
<tr>
<td>Changes in Cash and Temporary Investments</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Source and Use of Funds</td>
<td>3</td>
<td>14</td>
</tr>
<tr>
<td>Source and Disposition of Funds</td>
<td>3</td>
<td>14</td>
</tr>
<tr>
<td>Source of Net Current Assets</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Funds provided and Applied</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Statement of Cash Flow</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Disposition of Funds</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Funds Statement</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td>22</td>
<td>100%</td>
</tr>
</tbody>
</table>


18 Although these statements generally had titles, some of them were included under the caption, "working capital," in the financial notes of the annual reports.
The following tabulation shows the meanings given to the term, "funds," in the 22 companies:

<table>
<thead>
<tr>
<th>Meaning</th>
<th>Number of companies</th>
<th>Per cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Working Capital</td>
<td>17</td>
<td>77</td>
</tr>
<tr>
<td>Cash and Marketable Securities</td>
<td>2</td>
<td>9</td>
</tr>
<tr>
<td>Cash</td>
<td>2</td>
<td>9</td>
</tr>
<tr>
<td>Unable to determine</td>
<td>( \frac{1}{22} )</td>
<td>( \frac{5}{100})</td>
</tr>
</tbody>
</table>

The preceding tabulations show that in the annual reports studied the meaning of the term, "funds," is considered "working capital" in 17 of the 22 companies. It is interesting to note that the term, "funds," means "cash," or/and "cash and marketable securities," in some cases.

In 17 of the 22 companies, the term, "working capital," is mentioned in the title. This shows that at least some of the people who prepare these statements are trying to tell the readers what information is contained in the statements. This indicates that financial reporting is improving.

Each of the 22 statements studied was either the reconciliation type, the remainder type, or the balanced type.

The reconciliation type statement reconciles, for example, working capital at the beginning of the year with working capital at the end of the year. The following statement is an example of the reconciliation type:
American Broadcasting Paramount Theatres, Inc.
Source and Application of Funds

Working Capital, January 1, 1955 $ xx

Source of Funds:
- Net Income from Operations $ xx
- Provision for Depreciation xx
- Cash proceeds from capital gains transactions after taxes thereon xx
- Collection of Notes Receivable xx
- Proceeds from exercise of Stock options xx $ xx

Application of Funds:
- Dividends Paid - Preferred Stock $ xx
- Common Stock xx
- Purchase and redemption of preferred stock xx
- Fixed asset additions and replacements xx
- Repayments of notes issued under loan agreements xx
- Other - net xx $ xx

Working Capital at December 31, 1955 $ xx

The remainder type of statement lists the additions to working capital (sources) and deducts the subtractions from working capital (applications) leaving either an increase or decrease to working capital for the period. The following abbreviated statement is an example of the remainder type:

Armco Steel Corporation
Summary of Changes in Working Capital

Additions to Working Capital (listed) $ xx
Deductions from Working Capital (listed) xx
Increase or (decrease) in working capital $ xx


The balanced type of statement shows that the funds provided (sources, additions to working capital) equal the funds applied (deductions from working capital or applications). In this statement the increase in working capital is included in the "deductions" sections, or the decrease is included in the "additions" section of the statement. An example of the balanced type follows:

Continental Oil Company  
Source and Disposition of Funds

Sources (listed) $xx
(decrease in working capital included in sources)

Disposition (listed) $xx

The following tabulation shows how the funds statement of the 22 companies are divided as to reconciliation, remainder, or balanced type:

<table>
<thead>
<tr>
<th>Type</th>
<th>Number</th>
<th>Per Cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reconciliation</td>
<td>10</td>
<td>45</td>
</tr>
<tr>
<td>Remainder</td>
<td>7</td>
<td>32</td>
</tr>
<tr>
<td>Balanced</td>
<td>5</td>
<td>23</td>
</tr>
<tr>
<td>Total</td>
<td>22</td>
<td>100%</td>
</tr>
</tbody>
</table>

In this sample the reconciliation type statement was found in more cases than was the remainder type. The textbook...

---


The remainder type of statement was used with the "Conventional funds statement" in Chapter III of this study. In Chapter IV, the "Original funds statement" and the "all-inclusive funds statement" are the balanced type statements. Paton's statement is the remainder type; the net quick asset type devised by Moonitz is the reconciliation type statement.
used in this study, generally, did not show any reconciliation type of funds statement.

Another interesting point brought out in this study is that sometimes the certified public accountant includes the funds statement in the scope and opinion paragraphs of his report. An example follows:

"Report of Independent Public Accountants

To the Share Owners, Butler Brothers:

We have examined the consolidated balance sheet of BUTLER BROTHERS (an Illinois Corporation) and subsidiary company as of December 31, 1956, and the related statements of income, earned surplus and source and disposition of funds for the year then ended. Our examination . . . .

In our opinion, the accompanying consolidated balance sheet and statements of income, earned surplus and source and disposition of funds present fairly the financial position of Butler Brothers and subsidiary company as of December 31, 1956, and the results of their operations for the year then ended, and were prepared in conformity with generally accepted principles applied on a basis consistent with that of the preceding year.

Arthur Anderson & Co.

Chicago, Illinois

February 8, 1957"23

Accounting Trends and Techniques shows that approximately 18 percent of the funds statements included in the 1955 reports to stockholders have been "certified" by the Certified Public

231956 Annual Report of Butler Brothers and Subsidiary Company.
Accountants. This, of course, does not mean that the certified public accountant necessarily mentions the statement specifically in his report as was done in the report of the Butler Company.

**Summary**

Certified public accountants include the funds statement in long form audit reports more today than they did ten years ago. The most common fund-statement titles used by the certified public accountants in the long form reports are "statement of sources and application of funds" and "statement of application of funds." Although the "working capital" concept is generally used by the certified public accountants, the "cash" and "cash equivalent" concepts are also sometimes used.

Certified public accountants include the funds statement in their reports to aid the management of the companies audited in understanding the other financial statements. For example, the funds statement helps to explain why working capital increased more than the net income appearing on the income statement. Certified public accountants also use the funds statement in conjunction with the capital budget. The most valuable function of the funds statement, according to the certified public accountants, is to show why the working capital increased or decreased for the period under review.

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24 Accounting Trends and Techniques in Published Corporate Annual Reports, op. cit., pp. 37, 40.
The bankers who were interviewed during the course of this study appreciate the funds statement because they are very much interested in the working capital position of their borrowers. Bankers analyze the working capital position of companies and attempt to determine the future needs of the companies. The funds statement presents additional, pertinent information to the bankers so that they "don't have to dig so much." Bankers are also interested in the cash position of their borrowers.

A member of the management of a large oil refinery stated that the management of this particular company uses the funds statement to show how the expansion of the company was financed. The funds statement is used in conjunction with the capital budget to aid in determining the capital outlays for the coming year.

Anton's study shows that the management of larger corporations uses the funds statement to a greater degree than the management of smaller companies. Although 50 per cent of the users of the funds statements for internal (management) purposes consider that the term, "funds," means "working capital," over 30 per cent of the users consider the term, "funds," to mean "cash," or "cash equivalent."

The funds statement is a planning statement; however, it is also an accountability statement to aid management in reporting on financial stewardship to the stockholders.
The study of the annual reports to stockholders shows that twenty-two per cent of the companies include funds statements in the annual reports. Approximately one third of the companies included in the sample titled the funds statement "summary of working capital changes," or some similar title with the term, "working capital," included. These "working capital" statements were similar to the "conventional statement" explained in Chapter III of this study; however, the titles with "working capital" included in them certainly are preferred because they (the titles) do a much better job of explaining the content of the statement.

The most common type of statement included in the 100 companies studied was the "reconciliation" type statement. The next most common type was the "remainder" type, followed by the "balanced" type statement.

An interesting point is the fact that approximately 18 per cent of the funds statements included in the annual reports to stockholders were "certified" by the certified public accounting firms who audited the companies.

Generally, the users of funds statements are interested in the cash position, the working capital, and the transactions which caused these items to change.
CHAPTER VI
THE NEW FUNDS STATEMENT

It is the purpose of this chapter to review the needs of the users of funds statements, to review the information various funds statements mentioned in this study present, and to attempt to devise a statement which fits the needs of the users in a general way.

It was found in this study that the users of the fund statements are management, bankers, certified public accountants, stockholders, and investment analysts. Although in each of these groups the information is used in different ways, much the same information is needed for each group.

All of the above mentioned groups, combined, need to know the following information: data concerning short-term and long-term financing; why the cash position of the unit changed; why the working capital position of the unit changed; why the working capital and/or cash changed in a different direction than the profit or loss from operations; and how the management used the assets coming into the business unit from the financing transactions. Of course the preceding desired information is overlapping.

The conventional funds statement does not present all of the above information. It does not show why the cash changed,
it does not show the short-term financing, and it does not show the financing transactions which occurred if these transactions did not affect the working capital.

The Paton statement shows about the same information as the conventional funds statement except that it shows the full flow of items coming into the working capital area concerning operations (revenues) less the full flow of items leaving the working capital area (expenses, excluding depreciation, depletion, and amortization), and the Paton statement presents more of a detailed classification of the items in the funds statement.

The "all-inclusive" funds statement shows about the same information as the conventional funds statement except that it shows financing transactions occurring in the noncurrent accounts which have no effect on working capital.

The "net quick asset" funds statement devised by Moonitz shows both short-term and long-term financing transactions, it shows other financing transactions even though these transactions have no affect on working capital; however, the "net quick asset" funds statement does not show clearly why the cash position changed or why the working capital position of the unit changed.

The original funds statement shows merely the changes in the comparative balance sheets. It does not show why the cash position changed, it does not show why the working
capital changed, and it does not show (except indirectly) long-term and short-term financing.

Although the cash-flow statement shows the short-term and long-term financing transactions if the transactions affected cash and shows why the cash position changed during the period, the cash-flow statement does not show why the working capital changed during the period. The cash-flow statement, of course, does not show any transactions which do not affect cash.

Although each of the previously named statements has contributed much to the fund statement development, none of these statements presents all of the information generally needed by all groups of users. The following discussion concerns a general purpose funds statement which is titled "Statement Summarizing Financial Transactions and Explaining Why the Cash and Working Capital Changed." A shorter title is desired; however, a shorter title might not portray the contents of the statement. In this study the "Statement Summarizing Financial Transactions and Explaining Why Cash and Working Capital Changed," is called the "New Funds Statement." The abbreviated title is used to facilitate the discussion. It is suggested that in the future, the term, "funds," be discontinued concerning "funds" statements because of the ambiguity of the term. If one of the previously mentioned "funds" statements is used, the heading should portray the contents of the statement.
The New Funds Statement presents all of the previously mentioned, desired information in one statement with an attached schedule. The statement is fairly easy to prepare, and it should be easily interpreted because the key figures can be traced to the income statement and comparative balance sheets. The section of the statement pertaining to cash may be used with the cash budget; the section of the statement pertaining to working capital may be used in connection with the capital budget.

The New Funds Statement shows the full flow of items coming into the cash and the full flow of items leaving cash. It shows the full flow of items entering the working capital area and the full flow of items leaving the area. While the new funds statement does not present a "net profit" figure which can be traced to the income statement, the reader can easily reconcile the increase in working capital from "operations" figure with the net income figure per income statement by deducting the depreciation, depletion, and amortization charges from the "operations" figure on the funds statement. In other words, the "operations" figure less the amortization, depletion, and depreciation charges equals the net income figure on the income statement. The New Funds Statement summarizes the financial transactions without mentioning the term, "funds."

---

1See Appendix C for preparation of New Funds Statement by using a worksheet.
Although the New Funds Statement contains some items in both the cash section and the working capital section, this repetition is necessary to show both long-term and short-term financing and to show why the cash position changed and why the working capital changed. A person who knows that cash is part of working capital realizes that many items, such as the proceeds from a bond issue, affect both cash and working capital.

The construction of an accounting statement must be carefully planned. As in the construction of a building, the foundation must be adequate, and the materials used should be sound and tested. The framework must be solidly connected to the foundation.

The New Funds Statement has a solid foundation; it is built from the comparative balance sheet, the income statement, and basic accounting records. The balance sheet and the income statement are still considered the basic accounting statements. The New Funds Statement is built with the aid of the conventional funds statement principles and with the aid of fund statement developments which have taken place rather recently, such as the full flow concept suggested by Paton and Paton and some of the developments of Moonitz and Anton. Although the New Funds Statement is built on some of the older financial statements and contains some of the concepts developed by other people, it is felt to be the first.
statement which presents all of the needed financing information to the users in a way in which the users may use it effectively.

The New Funds Statement is firmly connected to its foundation because, as previously mentioned, it contains key figures which may be traced to the income statement and the balance sheets.

The New Funds Statement, built on a solid foundation, built with solid materials, and tied firmly to the foundation, should be capable of becoming the third major statement to be used with the balance sheet and the income statement.

Preparation of Statement

Appendix C shows how the new funds statement is prepared by using a worksheet. In most ordinary situations, a worksheet is not necessary; however, in complicated situations, a worksheet should be used. Instead of devising a cash flow statement for the top section of the New Funds Statement, the accountant can use the cash receipts and cash disbursements journals to acquire the necessary information. Although the worksheet presented in Appendix C is a very usable one, the accountant may use any type he desires to accomplish his purpose.

The following is a model of the new funds statement:
STATEMENT SUMMARIZING FINANCIAL TRANSACTIONS AND EXPLAINING WHY CASH AND WORKING CAPITAL CHANGED

For the Year Ended December 31, 1957

Cash was increased by:

- Customer Receipts $ 90,000
- Bond Issue 9,000
- Short term loan 11,000
- Issuance of Capital Stock 6,500

$116,500

Cash was decreased by:

- Short term loan retirements $ 5,000
- Payments for merchandise 43,800
- Payments for expenses 32,700
- Payments for building 20,000
- Payments for equipment 10,000 111,500

NET INCREASE IN CASH $ 5,000

DEDUCT: NET DECREASE IN WORKING CAPITAL

ITEMS OTHER THAN CASH (Schedule 1) 6,500

NET DECREASE IN WORKING CAPITAL $ 1,500

THE DECREASE IN WORKING CAPITAL IS EXPLAINED AS FOLLOWS:

Working capital was increased by:

- Bond issues $10,000
- Less: Bond issued for land 1,000 $ 9,000
- Issuance of Stock 6,500
- Operations:
  - Sales $100,000
  - Less: All other expenses excluding depreciation and patent amortization 86,000 14,000 $ 29,500

Working Capital was decreased by:

- Acquisition of land $1,000
- Deduct: (Bonds issued for land - see above) 1,000

- Acquisition of Building $20,000
- Acquisition of Equipment 10,000
- Dividend Declaration 1,000 31,000

NET DECREASE IN WORKING CAPITAL $ 1,500

Figure 9 - The New Funds Statement: Statement Summarizing Financial Transactions and Explaining Why Cash and Working Capital Changed
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Assets:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts Receivable( net)</td>
<td>$19,800</td>
<td>$28,800</td>
<td>$9,000</td>
<td></td>
</tr>
<tr>
<td>Marketable securities</td>
<td>5,000</td>
<td>5,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td>15,000</td>
<td>10,000</td>
<td>$5,000</td>
<td></td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>2,000</td>
<td>1,000</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td><strong>Current Liabilities:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividend Payable</td>
<td>-0-</td>
<td>1,000</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td>Accrued expenses</td>
<td>1,500</td>
<td>2,800</td>
<td>1,300</td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td>8,000</td>
<td>9,200</td>
<td>1,200</td>
<td></td>
</tr>
<tr>
<td>Short term loans payable</td>
<td>5,000</td>
<td>11,000</td>
<td></td>
<td>6,000</td>
</tr>
<tr>
<td><strong>DECREASE IN WORKING CAPITAL ITEMS</strong></td>
<td></td>
<td></td>
<td>$9,000</td>
<td>$15,500</td>
</tr>
<tr>
<td>(Excluding Cash)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>6,500</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>$15,500</td>
<td>$15,500</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The New Funds Statement may be used as a teaching device. It has been found that many students consider that the profit of a business unit for a specified period of time means "cash." In reviewing the particular company's operations for a certain period and by using the New Funds Statement in conjunction with the income statement and the balance sheet, the student might immediately see that the cash has increased or decreased in a different amount and in a different direction than the amount of the profit for the period and, more important, the student might see why the preceding events occurred.

The New Funds Statement should be included in every stockholders' annual report and in every audit report. The auditor who performed the audit for the company involved should present his opinion on the funds statement as well as the balance sheet and the income statement. Although certified public accountants are probably doing a good job of auditing cash, the inclusion of the cash receipts and cash disbursements in the New Funds Statement, and the inclusion of the funds statement in the "certified" report might require the certified public accountant to give more attention to the proof of cash as he makes his audit. The same comments pertaining to cash in the auditor's opinion also apply to the items in the working capital section of the funds statement.
Concepts pertaining to the new funds statement

The two most important statements which accountants prepare have been the balance sheet and the income statement. The balance sheet shows the assets, liabilities, and owners' equity of a particular business unit at a particular date. The income statement shows the detailed analysis of the revenues and expenses; it shows how the net income is computed. The New Funds Statement shows long-term and short-term financing and the effects of this financing on the business unit. The New Funds Statement shows why the cash changed and why the working capital changed.

The working capital concept is very significant because a business unit must be kept on a stable, current operating basis, and most transactions of a business unit affect the working capital. The users of fund statements recognize the importance of adequate reporting on the working capital position.

Although the amount of cash on hand is not usually considered more important than any other asset, an analysis of the cash account explains many of the current happenings of the business unit such as short-term financing transactions.
CHAPTER VII
SUMMARY AND CONCLUSIONS

Management exercises financial stewardship as well as operating stewardship; therefore management should report on the financial as well as the operating stewardship.

The conventional funds statement which shows why the working capital of a business unit increased or decreased during a certain period is a very important statement because it shows some of the more important financing transactions which have occurred. However, there are some financing transactions which are not shown on the conventional statement. Transactions not shown include the issuance of short-term loans, the repayment of short-term obligations, and other financing transactions which have occurred within the working capital group.

The conventional funds statement does not show financing transactions which have occurred in the noncurrent accounts if the transactions have no effect on working capital. For example, the retirement of bonds from a sinking fund is not shown on the conventional funds statement because the sinking fund is generally carried in the noncurrent classification on the balance sheet.
The working capital, defined in this study, is the current assets less the current liabilities. The working capital of a business unit is very significant. Having adequate working capital is an important requirement for preserving good trade and bank credit, for meeting all expenses and liabilities promptly, and for taking care of emergency and special needs. Although an adequate amount of working capital is necessary, an excessive amount may reduce the return on investment and encourage waste and manipulation.

The primary sources of working capital shown on the conventional funds statement are: (1) the proceeds from the sale of noncurrent assets; (2) the proceeds from the issuance of noncurrent liabilities; (3) the proceeds from the issuance of common and preferred stock; and (4) the revenues from operations. The primary uses of working capital are: (1) the retirement of long-term debt (assuming that there is no sinking fund); (2) the acquisition of noncurrent assets; (4) the declaration of cash dividends; and (5) operating expenditures.

Although the conventional funds statement does not show the revenues as a source of funds (working capital) and the operating expenditures as a use of funds as described in the above paragraph, the conventional statement shows the net increase in funds resulting from operations. The net increase in funds resulting from operations may be calculated
for fund statement purposes by subtracting the operating expenditures (including depreciation, depletion, amortization, and other non-working capital items) from the revenues, or the increase in funds from operations may be calculated by adding the non-working capital charges such as depreciation, depletion, and amortization to the net income figure appearing on the income statement. The latter method is used in the conventional statement.

In order to determine whether or not other funds statements present any additional financing information not found on the conventional statement, the following other fund statements were examined: the original funds statement, the "all-inclusive" funds statement, the Paton funds statement, the net quick asset funds statement, and the cash flow statement.

The original funds statement merely lists the changes in the comparative balance sheets. The credit changes are listed at the top section of the statement under the caption, "where got," and the debit changes are listed at the bottom of the statement under the caption, "where gone." Although a general idea of the financing transactions may be obtained from a study of the original funds statement, no specific information can be obtained because no further analysis of the accounts is made in the preparation of the statement. For example, the statement shows only that the retained earnings account has changed a certain amount; the net income,
the dividend declarations, and other changes in retained earnings are not shown. The statement does not show why the working capital changed.

The "all-inclusive" funds statement is similar to the conventional funds statement except that the all-inclusive statement shows additional financing transactions which have no effect on the working capital. For example, the all-inclusive funds statement shows the acquisition of a building if the building is acquired by the issuance of a long-term liability. The all-inclusive funds statement also shows the declaration of a stock dividend.

The Paton statement includes approximately the same information as the conventional funds statement; however, the Paton statement does show the revenues as increasing the working capital and shows the operating expenditures as reducing the working capital, resulting in a net increase to the working capital from operations. The Paton statement is a step-by-step statement whereas the conventional funds statement is a two-section statement showing the increase or decrease of working capital.

The net quick asset funds statement explains why the net quick assets (cash, liquid receivables, marketable securities, less current liabilities excluding bank loans) increased or decreased during the period. According to Moonitz, the funds statement should show all external financing transactions;
therefore, the net quick asset statement reviewed in this study shows both long-term and short-term financing. The statement shows noncurrent gifts coming into the business unit because the gifts come from an external source. Although the net quick asset statement shows much more financing transactions than the conventional funds statement, the net quick asset statement does not show why either the working capital or the cash changed for the period. The statement is inconsistent in that it includes noncurrent assets coming into the unit as an increase in funds when funds are described as net quick assets.

The cash flow statement shows why the cash changed for the period under review by showing the changes in the non-cash accounts which affected the cash. The statement shows long-term and short-term financing and all other transactions which affected the cash during the period. The cash flow statement does not show why the working capital changed and does not show the increase in working capital resulting from the operations of the company on the accrual basis of accounting.

To determine what the users of the fund statements desire, common fund statement titles, the definition of the term, "funds," and other information, the following procedures were used in this study: articles showing the results of studies and surveys made by Kempner, Anton, and
Horngren were examined; a survey was conducted at the annual meeting of the Society of Louisiana Certified Public Accountants held at Lafayette, Louisiana; interviews were carried on with management, certified public accountants, and bankers; and a study was made of 100 annual reports (mostly 1956 reports) filed in the College of Commerce Library of the Louisiana State University.

In certified public accounting practice the most common titles for the funds statements are "statement of sources and applications of funds" and "statement of application of funds." In stockholders' reports the funds statement titles usually contain the term "working capital." The most common meaning for the term, "funds," is working capital. A general conclusion is that the conventional funds statement is the most commonly used funds statement at the present time. Funds statements are gaining in popularity; they are used more at the present time than they were ten years ago.

The above studies show that the principal users of the funds statements are management, stockholders, accountants, bankers, and investment analysts. To fit the needs of all the users, the funds statement should present the following (overlapping) information: it should show why the cash and the working capital changed for a certain period; and it should show short-term and long-term financing transactions.

A new type of funds statement was devised during the course of this study which presents the necessary information
to the users. The New Funds Statement titled, "Statement Summarizing Financial Transactions and Explaining Why Cash and Working Capital Changed," is easy to understand and is easily prepared. The new statement shows short-term and long-term financing transactions whether or not these transactions affect working capital and/or cash. The statement shows why the cash and the working capital changed during the period, and the key figures on the statement may be easily traced to the comparative balance sheets and the income statement. As the statement does not include the term, "funds," in its heading, there is not the ambiguity which is usually found in most fund statements with the term, "funds," in the title.

The New Funds Statement not only reports on the financial stewardship of management, but it presents the other required information mentioned previously such as showing why the working capital and the cash changed for the period. The statement may be used by management in conjunction with the budgets. The New Funds Statement should be included in all audit reports and in the annual stockholders' reports.
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B. Periodicals


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C. Accounting Research Bulletin


D. Annual Reports


APPENDIX A

Questionnaire Distributed at Annual Meeting of the Society of Louisiana Certified Public Accountants, Lafayette, Louisiana, May 23-24, 1957

Dear Practicing CPA,

I am making a study of the funds statement as a partial requirement for the Ph.D. degree. I would greatly appreciate your answers to the questions listed below.

Sincerely,

Robert L. Kvam, CPA
Instructor in Accounting
Louisiana State University

1. Do you include a funds statement (also called statement of sources and application of funds and various other titles) in your long form reports?
   _____ Occasionally
   _____ in every report or
   _____ nearly in every report

2. Did you include a funds statement in your long form reports 10 years ago?
   _____ Occasionally
   _____ Never
   _____ in every report or
   _____ nearly in every report

3. What title do you place on your funds statement?
   _____ Statement of Sources and Applications of Funds
   _____ Statement of Application of Funds
   _____ Statement of Changes in Working Capital
   _____ Statement of Sources and Disposition of Funds
   _____ Statement of Funds Derived and Applied
   _____ Other, Please mention your title ____________________

4. In your opinion, what is the meaning of the word, "funds," in the funds statement?
   _____ Working Capital
   _____ Net quick assets (cash, receivables-liquid, marketable securities, less current liabilities)
   _____ All balance sheet items
   _____ Other, please specify ________________________________

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APPENDIX B

100 Annual Stockholders' Reports Included in Study

1. Alabama Power Company
2. Acme Steel Corporation
3. Allied Chemical & Dye Corporation
4. Aldens
5. Allis-Chalmers
6. Aluminum Company of America
8. American Airlines, Inc.
9. American Can Company
10. American & Foreign Power Company, Inc.
11. American Home Products Corporation
12. American Gas & Electric Company
13. The American Metal Company, Limited
14. The American Laundry Machinery Company
15. American Steel Foundries
16. The American Sugar Refinery Company
17. American Telephone and Telegraph Company
18. The American Tobacco Company
19. Argus Annual Report
20. Arkansas Fuel Oil Corporation
21. Argo Oil Corporation
22. American Zinc, Lead and Smelting Company
23. American Writing Paper Corporation
24. Anaconda Company
25. American Motors Corporation
26. Armco Steel Corporation
27. Armour and Company
28. Armstrong Cork Company
29. Avco
30. The Atlantic Refinery Company
31. Baldwin, Lima, Hamilton
32. Beatrice Foods Co.
33. The Baltimore and Ohio Railroad Company
34. Bell Aircraft Corporation
35. Beech-Nut Life Savers, Inc.
36. Bethlehem Steel Corporation
37. Blaw-Knox Company
38. Bon Ami Company
39. The Borden Company
40. Bruck Mills Limited
41. Briggs & Stratton Corporation
42. Briggs
43. Butler Brothers
44. Bush Terminal Company
45. Burroughs Corporation
46. Bulova
47. Capital Airlines
48. Canada Dry
49. Carnation Company
50. Carter Oil Company
51. Caterpillar Tractor Company
52. Chain Belt Company
53. The Celotex Corporation
54. Chrysler Corporation
55. Cities Service Company
56. The City Auto Stamping Company and Subsidiaries
57. Cleveland Transit System
58. The Coca-Cola Company
59. Clevite Corporation
60. Colgate-Palmolive Company
61. Columbia Broadcasting System
63. Columbia Pictures
64. Commercial Credit Company
65. Commonwealth Edison Company
66. Consolidated Natural Gas Company
67. Consolidated Edison Company of New York
68. Continental Air Lines
69. Continental Can
70. Continental Oil
71. McCrory Stores Corporation
72. McKesson & Robbins
73. R. H. Macy & Co., Inc.
74. Coty International Corporation
75. Coty, Inc.
76. Crane Company
77. Cudahy Packing Company
78. Curtis Publishing Company
79. Dayton Power and Light Company
80. The Delaware and Hudson Railroad Corporation
81. The Denver Tramway Corporation
82. The Detroit Edison Company
83. The Dow Chemical Company
84. E. I. DuPont de Nemours & Company
85. Eastern Airlines, Inc.
86. Eastman Kodak Company
87. Electrolux Corporation
88. Erie Railroad Company
89. Ex-Cello Corporation
90. Freeport Sulphur Company
91. Fluor Corporation, Ltd.
92. Fruehauf Trailer Company
93. Fuller Brush Company
94. General Aniline & Film Corporation
95. General Cable Corporation
96. General Electric
97. General Mills, Inc.
98. General Foods Corporation
99. General Finance Corporation
100. General Public Utilities
APPENDIX C

STATEMENT SUMMARIZING FINANCIAL TRANSACTIONS AND EXPLAINING WHY CASH AND WORKING CAPITAL CHANGED

WORK SHEET AND ADJUSTING ENTRIES TO SHOW THE PREPARATION OF THE STATEMENT IF A WORK SHEET IS USED
STATEMENT SUMMARIZING FINANCIAL TRANSACTIONS AND EXPLAINING WHY CASH AND WORKING CAPITAL CHANGED

For the Year Ended December 31, 1957

Cash was increased by:

Customer Receipts $ 90,000
Bond Issue 9,000
Short-term loan 11,000
Issuance of Capital Stock 6,500

Cash was decreased by:

Short-term loan retirements $ 5,000
Payments for merchandise 43,800
Payments for expenses 32,700
Payments for building 20,000
Payments for equipment 10,000 111,500

NET INCREASE IN CASH $ 5,000

DEDUCT: NET DECREASE IN WORKING CAPITAL ITEMS OTHER THAN CASH (Schedule 1) 6,500

NET DECREASE IN WORKING CAPITAL $ 1,500

THE DECREASE IN WORKING CAPITAL IS EXPLAINED AS FOLLOWS:

Working capital was increased by:

Bond issues $ 10,000
Less: Bond issued for land 1,000 $ 9,000
Issuance of Stock 6,500
Operations:
Sales $100,000
Less: All other expenses excluding depreciation and patent amortization 86,000 14,000 $ 29,500

Working capital was decreased by:

Acquisition of land $1,000
Deduct: (Bonds issued for land - see above) 1,000

Acquisition of Building $ 20,000
Acquisition of Equipment 10,000
Dividend Declaration 1,000 31,000

NET DECREASE IN WORKING CAPITAL $ 1,500
Schedule 1

NET DECREASE IN OTHER WORKING CAPITAL ITEMS
.EXCLUDING CASH)

<table>
<thead>
<tr>
<th></th>
<th>Dec. 31 1956</th>
<th>Dec. 31 1957</th>
<th>Working Capital Increase</th>
<th>Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Assets:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>$19,800</td>
<td>$28,800</td>
<td>$ 9,000</td>
<td></td>
</tr>
<tr>
<td>(net)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Marketable securities</td>
<td>5,000</td>
<td>5,000</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td>15,000</td>
<td>10,000</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>2,000</td>
<td>1,000</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td><strong>Current Liabilities:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Dividend Payable</td>
<td>-0-</td>
<td>1,000</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td>Accrued expenses</td>
<td>1,500</td>
<td>2,800</td>
<td>1,300</td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td>8,000</td>
<td>9,200</td>
<td>1,200</td>
<td></td>
</tr>
<tr>
<td>Short-term loans payable</td>
<td>5,000</td>
<td>11,000</td>
<td>6,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>$ 9,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>$15,500</td>
<td></td>
</tr>
<tr>
<td><strong>DECREASE IN WORKING CAPITAL ITEMS</strong></td>
<td>$6,500</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Excluding Cash)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

|                      | $15,500      | $15,500      |                          |          |
## WORK SHEET FOR STATEMENT SUMMARIZING FINANCIAL T 1

### December 31 Net Changes Adjustments to Cash Section

<table>
<thead>
<tr>
<th></th>
<th>1956</th>
<th>1957</th>
<th>dr</th>
<th>cr</th>
<th>dr</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash</strong></td>
<td>10000</td>
<td>15000</td>
<td>5000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Accounts Receivable</strong></td>
<td>20000</td>
<td>30000</td>
<td>10000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Marketable Securities</strong></td>
<td>5000</td>
<td>5000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Inventory</strong></td>
<td>15000</td>
<td>10000</td>
<td>5000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Prepaid Expenses</strong></td>
<td>2000</td>
<td>1000</td>
<td>1000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Land</strong></td>
<td>2000</td>
<td>3000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Building (4% Depr.)</strong></td>
<td>20000</td>
<td>40000</td>
<td>1000</td>
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<tr>
<td><strong>Equipment (20% Depr.)</strong></td>
<td>18000</td>
<td>28000</td>
<td></td>
<td></td>
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<tr>
<td><strong>Patents</strong></td>
<td>1700</td>
<td>1600</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Dividend Payable</strong></td>
<td>1000</td>
<td>1000</td>
<td>1000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Accrued Expenses</strong></td>
<td>1500</td>
<td>2800</td>
<td>1300</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Allowance for Bad Debts</strong></td>
<td>200</td>
<td>1200</td>
<td>1000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Allowance for Depr.-Bldg.</strong></td>
<td>2400</td>
<td>3200</td>
<td>800</td>
<td></td>
<td></td>
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<tr>
<td><strong>Allowance for Depr.-Equip.</strong></td>
<td>10800</td>
<td>14400</td>
<td>3600</td>
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<tr>
<td><strong>Accounts Payable</strong></td>
<td>8000</td>
<td>9200</td>
<td>1200</td>
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<tr>
<td><strong>Short-term Loans Payable</strong></td>
<td>5000</td>
<td>11000</td>
<td>6000</td>
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<tr>
<td><strong>Bonds Payable</strong></td>
<td>10000</td>
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<td>10000</td>
<td>9000</td>
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<td><strong>Capital Stock</strong></td>
<td>50000</td>
<td>66000</td>
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<td>6000</td>
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<tr>
<td><strong>Premium on Capital Stock</strong></td>
<td>5000</td>
<td>500</td>
<td></td>
<td>500</td>
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<tr>
<td><strong>Retained Earnings</strong></td>
<td>5800</td>
<td>4800</td>
<td>1000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Sales</strong></td>
<td>100000</td>
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<td></td>
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<tr>
<td><strong>Bad Debt Expense</strong></td>
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<td>1000</td>
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<tr>
<td><strong>Cost of Sales</strong></td>
<td>(5000)</td>
<td>50000</td>
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<td></td>
<td></td>
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<tr>
<td><strong>Other Expenses</strong></td>
<td>(35000)</td>
<td>35000</td>
<td></td>
<td></td>
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<tr>
<td><strong>Depreciation - Bldg.</strong></td>
<td>(800)</td>
<td>800</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td><strong>Depreciation - Equip.</strong></td>
<td>(3600)</td>
<td>3600</td>
<td></td>
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<tr>
<td><strong>Amortization-Patents</strong></td>
<td>(100)</td>
<td>100</td>
<td></td>
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</table>

**Total** | **93700** | **133600** | **137500** | **137500**
## Financial Transactions and Explaining Why Cash and Working Capital Changed

### Cash Section

<table>
<thead>
<tr>
<th>Cash Section</th>
<th>Adjustments</th>
<th>Working Capital Section</th>
<th>Working Capital Items</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>dr</td>
<td>cr</td>
<td>dr</td>
</tr>
<tr>
<td>90000 (1)</td>
<td>100000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5000</td>
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<td></td>
<td>5000</td>
</tr>
<tr>
<td>1000</td>
<td>600</td>
<td>1000</td>
<td></td>
</tr>
<tr>
<td>(6) 1000</td>
<td></td>
<td></td>
<td>(a) 1000</td>
</tr>
<tr>
<td>(8) 20000</td>
<td></td>
<td></td>
<td>(b) 20000</td>
</tr>
<tr>
<td>(9) 10000</td>
<td></td>
<td></td>
<td>(c) 10000</td>
</tr>
<tr>
<td>1000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1300</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>1000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>800</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3600</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1200</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11000 (11) 5000</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>9000</td>
<td></td>
<td></td>
<td>(a) 1000</td>
</tr>
<tr>
<td>1000</td>
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<td>6000</td>
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<td>(f) 6000</td>
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<td>500</td>
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<td></td>
<td>(f) 500</td>
</tr>
<tr>
<td>(10) 1000</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>800000</td>
<td></td>
<td></td>
<td>(g) 1000</td>
</tr>
<tr>
<td>(2) 1000</td>
<td></td>
<td></td>
<td>(h) 100000</td>
</tr>
<tr>
<td>(3) 50000</td>
<td></td>
<td></td>
<td>(h) 100000</td>
</tr>
<tr>
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<td></td>
<td></td>
<td>(d) 35000</td>
</tr>
<tr>
<td>(5) 60000</td>
<td></td>
<td></td>
<td>(d) 3600</td>
</tr>
<tr>
<td>(5) 100000</td>
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<td></td>
<td>(d) 100</td>
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WORK SHEET FOR STATEMENT SUMMARIZING FINANCIAL TRANSACTIONS AND EXPLAINING WHY CASH AND WORKING CAPITAL CHANGED  
(Continued)

<table>
<thead>
<tr>
<th>December 31</th>
<th>Net Changes</th>
<th>Adjustments for Cash</th>
<th>Working Capital Section</th>
<th>Working Capital Section</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>dr</td>
<td>cr</td>
<td>(decreased)</td>
<td>(increased)</td>
</tr>
<tr>
<td>1956</td>
<td>dr</td>
<td>cr</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1957</td>
<td>dr</td>
<td>cr</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Increases:</td>
<td>Adjustments for Working Capital</td>
<td>Working Capital Items</td>
<td></td>
<td></td>
</tr>
<tr>
<td>By Customer Receipts</td>
<td>dr</td>
<td>cr</td>
<td>(decreased)</td>
<td>(increased)</td>
</tr>
<tr>
<td>From Bond Issue</td>
<td>(1) 9000</td>
<td>9000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>From Short-term Loans</td>
<td>(7) 9000</td>
<td>9000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>From Issuance of Capital Stock</td>
<td>(11) 11000</td>
<td>11000</td>
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<td></td>
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<tr>
<td>(12) 6500</td>
<td>6500</td>
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<td></td>
</tr>
<tr>
<td>Cash Decreases:</td>
<td>Adjustments for Working Capital</td>
<td>Working Capital Items</td>
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<tr>
<td>Short-term Loan Repayments</td>
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<td>5000</td>
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<tr>
<td>For Merchandise</td>
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<td>4500</td>
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<td></td>
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<tr>
<td>For Expenses</td>
<td>(6) 3700</td>
<td>3700</td>
<td></td>
<td></td>
</tr>
<tr>
<td>For Building</td>
<td>(8) 20000</td>
<td>20000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>For Equipment</td>
<td>(9) 10000</td>
<td>10000</td>
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<td></td>
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<tr>
<td>Net Cash Increase</td>
<td>20400</td>
<td>20400</td>
<td>115500</td>
<td>115500</td>
</tr>
<tr>
<td>Working Capital Increases:</td>
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<td></td>
</tr>
<tr>
<td>From Bond Issues</td>
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<tr>
<td>From Issuance of Stock</td>
<td>(g) 14000</td>
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<tr>
<td>From Operations</td>
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<td></td>
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<tr>
<td>Working Capital Decreases:</td>
<td>(b) 20000</td>
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<td></td>
</tr>
<tr>
<td>For Building</td>
<td>(c) 10000</td>
<td>10000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>For Equipment</td>
<td>(g) 1000</td>
<td>1000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>For Dividend Declaration</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Working Capital Net Decrease</td>
<td>15200</td>
<td>15200</td>
<td>15000</td>
<td>15000</td>
</tr>
</tbody>
</table>

Net: 115500 115500
Adjustments for Cash Flow Section of Worksheet

(1) Sales -
   Accounts Receivable 100000
   To eliminate Sales
   Sales made on account have no effect on cash.

   Accounts Receivable 90000
   Increase in Cash 90000
   To show increase in cash from
   Customer Receipts and to explain change in Accounts Receivable.

(2) Allowance for Bad debts 1000
   Bad debt expense 1000
   To eliminate Bad debt charge - no effect on cash.

(3) Cash Decrease for Mdse.
    Inventory 5000
    Accounts Payable 1200
    Cost of Sales 50000
    To show cash applied for merchandise
    and to eliminate other items involved.

(4) Cash Decrease for Expenses 32700
    Prepaid expenses 1000
    Accrued Expenses 1300
    Other Expenses 35000
    To show cash applied for expenses and
    to eliminate accounts involved.

(5) Allowance for Depr. - Bldg. 800
    Allowance for Depr. - Equip. 3500
    Patents
       Depr. Expense - Bldg. 800
       Depr. Expense - Equip. 3600
       Patent Amortization 100
    To eliminate non-cash changes.

(6) Bonds Payable 1000
    Land 1000
    To eliminate non-cash Transaction.
    Records show that Bonds were issued directly for land.
(7) Bonds Payable  9000  
  Cash Increase  9000  
  To show increase in cash from bond issue and to explain remaining change in bond account.

(8) Cash Decrease  20000  
  Building  20000  
  To show cash applied to building and to eliminate change in building account.

(9) Cash Decrease  10000  
  Equipment  10000  
  To show cash applied to equipment and to eliminate change in equipment account.

(10) Dividend Payable  1000  
  Retained Earnings  1000  
  To eliminate dividend declaration - no effect on cash.

(11) Cash decrease  5000  
  Short term Loans Payable  5000  
  Short term Loans Payable  11000  
  Cash Increase  11000  
  To show old loan retirements and new loans occurring during year, assuming that the loan account showed the above transactions.

(12) Capital Stock  6000  
  Premium on Capital Stock  500  
  Cash Increase  6500  
  To show cash increase from sale of stock, and to explain changes in the non-cash accounts involved.
Adjustments on Work Sheet for Working Capital Section

(a) Bonds Payable
   Land 1000
   To eliminate non working capital transaction; to explain changes in these items.

(b) Working Capital Decrease
   Building 20000
   To show working capital used to acquire Building; to explain the changes in the building account.

(c) Working Capital Decrease
   Equipment 10000
   To show working capital used to acquire equipment; to explain the change in the equipment account.

(d) Patents
   Allowance for Depr. - Bldg. 800
   Allowance for Depr. - Equip. 3600
   Amortization - Patents 100
   Depreciation - Bldg. 800
   Depreciation - Equip. 3600
   To eliminate non-working capital items; to explain the changes in these accounts.

(e) Bonds Payable
   Working Capital Increase 9000
   To show issuance of Bonds to increase Cash and Working Capital; to explain the remaining change in the bond account.

(f) Capital Stock
   Premium on Capital Stock 500
   Working Capital Increase 5500
   To show how issuing stock increased Working Capital; to explain the changes in the Capital Stock and premium accounts.

*Although the transaction has no effect on either cash or working capital, it is shown on the new funds statement.
(g) Working Capital Decrease
Retained Earnings 1000
To show reduction in working capital for dividend declaration; to explain the change in retained earnings.

(h) Sales 100000
Bad debt expense 1000
Cost of Sales 50000
Other expenses 35000
Increase in working capital from Operations 14000
To eliminate accounts involved and to show the net increase in working capital from operations.
VITA

Robert Leroy Kvam was born in Sioux City, Iowa on November 14, 1920. He graduated from South Sioux City High School, South Sioux City, Nebraska, in 1939.

After high school graduation he attended Midland College, Fremont, Nebraska until 1940. From 1940 to 1942 he worked as teller, bookkeeper, and in insurance work for the Nebraska State Bank, South Sioux City, Nebraska.

He served in the Army of the United States from 1942 until 1946 as an enlisted man and as an aviation cadet.

After graduating from the University of South Dakota with a B.S. degree (accounting major), he worked as chief accountant with Equity Union Creameries, Incorporated, Aberdeen, South Dakota, and as a staff accountant with Strand and Roe, Certified Public Accountants, Minneapolis, Minnesota.

He attended the University of Colorado from 1951 until 1952 and received the M.S. degree in accounting in August, 1952.

He accepted an appointment as instructor in accounting at Louisiana State University in August, 1952. He also enrolled in the graduate school of Louisiana State University to work on the degree, Doctor of Philosophy, for which he is now a candidate.
In July, 1955, he received his Certified Public Accountants Certificate from the State of Louisiana.

In April, 1957, he accepted a position of Assistant Professor at Michigan State University.
Candidate: Robert Leroy Kvam

Major Field: Accounting

Title of Thesis: A New Funds Statement: Statement Summarizing Financial Transactions

Approved:

R. H. Van Voorhis
Major Professor and Chairman

Richard F. Russell
Dean of the Graduate School

EXAMINING COMMITTEE:

P. T. Boyd

W. E. Cracker

Date of Examination:

July 19, 1957