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THE SOURCE AND USE STATEMENT-AN AID TO PLANNING

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In the language of the accounting profession "the source and use statement" is referred to as the "Funds Flow Statement" and is essentially used for long term financial planning. I would like to broaden this discussion to include both the "Funds Flow Statement" and the Cash Flow Statement. The reasoning behind this expansion is to include both the long and short time span in discussion of accounting tools in financial planning.

A flow statement explains the changes that occurred in an account or a group of accounts during an accounting period. The income statement is a flow state; it explains the changes that occurred in retained earnings in connection with the operation of the business by summarizing the increase (ie, revenues) and decreases (ie, expenses) during the period. Another report, the funds flow statement, summarizes the events of the period from a different standpoint; it describes the sources from which additional funds were derived and the uses to which these funds were put. The fund flow statement is best described as a statement of the changes in net working capital.

The cash flow statement is used to identify changes in current assets and current liabilities. The payment for purchases and receipt of payment for sales only are involved. Transactions that do not involve a flow of cash are eliminated from this statement. The receipt of goods from a vendor on a 30 day account does not enter the cash flow statement until the money is transferred and neither does a credit sale to a customer until payment is received.

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The two flow statements-funds flow and cash flow-statements are used for two principal purposes 1) as a means of analyzing what has happened in the past and 2) as a means of planning what is going to happen in the future.

As a tool of historical analysis, the statement shed light on the financial policies that a firm has pursued. Of particular interest is the policy with respect to the acquisition of new fixed assets. To what extent were new assets financed by internally generated funds, and to what extent by borrowed or external sources? For financial resources obtained externally, what proportion was from debt and what from equity-member shares from the standpoint of the cooperative? Some cooperatives deliberately limit their growth to an amount that can be financed from internally generated funds. Others do not hesitate to go to outside sources for funds. For these the balance selected between risky, low-cost debt and less risky, higher cost equity is of considerable interest.

The funds flow statement is essentially derived from an analysis of changes that have occurred in asset and equity items between the balance sheet dates. It is not prepared directly from the accounts as is the balance sheet itself.

The funds flow statement shows changes in permanent capital and the assets in which this permanent capital is invested. It focuses on the more basic changes in the business rather than on the constantly recurring process of buying and selling goods and collecting receivables from customers.

Permanent capital consists of resources supplied by long-term creditors and by share holders, including both the original investment and the resources supplied by permitting retained earnings to remain in the business.

Part of the permanent capital is invested in buildings, equipment and other non-current assets. The remainder is invested in current assets, but only a fraction of current assets has to be financed from permanent capital, since vendors and short-term creditors provide the remainder. The amount that is financed from permanent capital is the difference between the total current assets and total current liabilities. This difference is referred to as working capital.

The funds flow statement shows changes in the total amount of working capital, but not fluctuations in the individual items comprising working capital. The word "funds" in this context has a specialized meaning. It is not synonymous with "cash" for cash is only one of the items comprising working capital. Rather, it is associated with permanent capital and the assets in which permanent capital is invested, one of which is working capital.

<u>The Funds Flow Statement</u>

As a tool of planning, a projected funds flow statement is an essential devise for planning the amount, timing and character of new financing. Estimated uses of funds for new fixed assets, for working capital, for repayment of debt and for dividends on class A stock and patronage dividends are all made for each of several future years, usually at least two or three years but in some cases 10 years or more. Estimates are made of the funds to be provided by operations and the difference, if it is positive, represents the funds that must be obtained by borrowing or the issuance of new equity securities (stocks). If the indicated amounts of new funds required is greater than management thinks it is feasible to raise, then the plans for new fixed asset acquisition and the dividend policies are re-examined so that the uses of funds can be brought into balance with anticipated sources of financing them.

BOISE CASCADE CORPORATION

Sources and Application of Funds
(in thousands of dollars)

	Year Ended December 31 1968	1967
Sources:		
Net income	$ 45,390	$ 29,544
Depreciation and depletion	31,437	29,419
Total from Operations	$ 76,827	$ 58,963
Borrowing under notes	30,397	78,499
Sale of property and equipment	17,196	8,293
Exchange of timber and operating properties	86,107	...
Increase in deferred income taxes	25,635	2,876
Exercise of stock options	1,305	2,858
Issuances of common stock	22,817	...
Miscellaneous	1,812	(1,911)
Total Sources	$262,096	$149,578
Applications:		
Property and equipment	$ 45,564	$ 52,093
Timber and timberlands	17,365	40,977
Capital expenditures	$ 62,929	$ 93,070
Investments in companies and realty	91,981	18,710
Increase in other noncurrent assets	3,520	23,327
Purchase of common stock for the treasury	...	3,061
Cash dividends declared	8,606	7,525
Reduction of timberland rental obligations	30,779	
Reduction of long-term notes and other obligations	71,877	23,599
Total Applications	$269,692	$169,292
Decrease in working capital	$ 7,596	$ 19,714

SOURCE: Condensed from 1968 annual report.

Cash Flow Statement

Instead of lumping all current assets and current liabilities together as working capital, it may be desirable to consider changes in some or all of these items separately. A statement that has this purpose is technically called a cash flow statement. Except that changes in individual current asset and liability items are treated separately, the procedures for analyzing transactions are the same as that for analyzing changes in permanent capital. Increases in assets and decreases in equities indicate use of cash; decreases in assets and increases in equity indicate sources of cash. Transactions that do not involve a flow of cash are eliminated.

For shorter term financial planning, a cash budget is essential. The cash budget is a cash flow statement except that the amounts are estimates of the future rather than those recorded in the past. Projections are made for each of the next several months or several quarters depending upon the nature of the business. Because of the seasonality of agriculture, the projection periods may vary from one agri-business firm to another.

One way to prepare a cash budget is to list all the estimated uses of cash and all the sources other than from additional financing. The difference between these totals is the amount that must be obtained by borrowing or selling additional equity if the planned program is to be carried out. If it is believed that this amount cannot be raised, the indication is that the estimated uses of cash must be cut back.

In making a cash budget, special attention is paid to the timing of the flows; that is, to the anticipated need for cash in each month or period covered. Particularity in businesses subject to seasonal fluctuations, there are likely to be heavy, but temporary, cash needs in months when inventories are being built up. These needs may be concealed in a cash budget statement that is not broken into short intervals of time.

The cash flow statement and the projected cash budget should be a guide to the financial officer in the firm in arranging for needed additional cash before the actual need arises. It can be helpful in checking actual performance against the planned operations. Lagging sales, slow collections, inventory built up from excessive purchases will all show up in a comparision of the cash budget with cash flow. The cash flow statement and cash budget can be used as an effective means of short term control over the firms operation.