Q1. Prepare a sources and uses of funds statement for ABC Corporation.

ABC Corporation,
Sources and uses of funds statement,
For December 31, 20X1 to December 31, 20X2 (in millions),

SOURCES		**USES**	
Funds provided by operations:			
Net profit	$5	Addition to fixed assets	$8
Depreciation	$5	Dividends	$3
Decrease, other assets	$5	Increase, account receivable	$7
Increase, account payable	$3	Increase, inventory	$5
Increase, accrued tax	$2	Decrease, note payable	$20
Increase, long term debt	$15		
Increase, common stock	$6		
Decrease, cash and cash equivalent	$2		
TOTAL	**$43**	**TOTAL**	**$43**

Q2. Using the data from Q1 prepare a cash flow statement using the indirect method for ABC Corporation.

ABC Corporation.

Statement of cash flow,

Year ended December, 31 20X2 (in millions).

- **<u>Cash-flow from Operating Activities:</u>**

Net income	$5
Depreciation	$5

Cash provided by current assets and
Operating-related current liabilities:

Increase, Account payable	$3
Increase, Accrued tax	$2
Increase, Account receivable	($7)

Increase, inventory	($5)	
Net cash provided by operating activities		**$3**
• **<u>Cash-flow from Investing Activities:</u>**		
Addition to fixed assets	($8)	
Proceeds from sales of other assets	$5	
Net cash provided by investing activities		**($3)**
• **<u>Cash-flow from Financing Activities:</u>**		
Decrease in short term bank borrowing	($20)	
Addition to long term debt	$15	
Proceeds from sales of stock	$6	
Dividends paid	($3)	
Net cash provided by financing activities:		**($2)**
Increase (decrease) in cash and cash equivalent	($2)	
Cash and cash equivalent, December 31 20X1	$5	
Cash and cash equivalent, December 31 20X2	**<u>$3</u>**	

Supplemental cash flow disclosure:

Interest paid $2

Taxes paid $4

Q3. (a) A company has to produce 100,000 units of output. It has to choose among three policies i.e. policy A, B & C. Policy A proposes to maintain current assets of worth 12 lacs, policy B of 10 lacs and policy C of 6 lacs. Which policy must the company choose if it has to increase liquidity, profitability and decrease risk? And why?

According to given detail, Company has to choose Policy B of 10 lacs. Company can produce up to 100,000 units of output a year.1 Production is continuous throughout the period under consideration, in which there is a particular level of output. For each level of output, the firm can have a number of different levels of current assets. initially, three different current asset policy alternatives the greater the output, the greater the need for investment in current assets to support that output. If we equate liquidity with Policy A is the most conservative of the three alternatives. At all levels of output, Policy A provides for more current assets than any other policy. The greater the level of current assets, the greater the liquidity of the firm Policy C is least liquid and can be labeled “aggressive and company has to increase liquidity so we can say that it has to choose Policy A, but on the other hand, company has also to increase profitability and decrease risk so we cannot choose Policy A because policy A will decrease profitability and if we choose policy C, It will decrease liquidity and we know that Company has t increase liquidity so we also cannot choose Policy C. So we have concluded that company will choose policy B.

(b) Briefly explain the maturity matching approach with an example.

Maturity matching approach

If the firm adopts a maturity matching approach to financing, each asset would be offset with a financing instrument of the same approximate maturity. Short-term or seasonal variations in current assets would be financed with short-term debt; the permanent component of current assets and all fixed assets would be financed with long-term debt or with equity. if long-term debt is used to finance short-term needs, the firm will be paying interest for the use of funds during times when these funds are not needed With a hedging approach to financing, the borrowing and payment schedule for short-term financing would be arranged to correspond to the expected swings in current assets, less spontaneous financing For example, company working capital is 5000 and temporary working capital is 1000 and current liabilities is also 1000 so this approach is maturity matching approach.

Q4. (a) Briefly explain permanent working capital with an example.

PERMANENT WORKING CAPITAL: working capital can be classified according to Components, such as cash, marketable securities, receivables, and inventory or Time, as either permanent or temporary A firm’s permanent working capital is the amount of current assets required to meet long-term minimum needs. You might call this “bare bones” working capital. Permanent working capital is similar to the firm’s fixed assets in two important respects. First, the dollar investment is long term, despite the seeming contradiction that the assets being financed are called “current.” Second, for a growing firm, the level of permanent working capital needed will increase over time in the same way that a firm’s fixed assets will need to increase over time. However, permanent working capital is different from fixed assets in one very important respect – it is constantly changing. Take a can of red paint and paint some of the firm’s fixed assets (like plant and equipment). If you come back in a month, these same assets are there and they are still red. Now, paint the firm's cash, receivable invoices, and inventory green. If you come back in a month, you may still find some green items, but many, if not most, will have been replaced by new, unpainted items. Thus permanent working capital does not consist of particular current assets staying permanently in place, but is a permanent level of investment in current assets, whose individual items are constantly turning over. Viewed still another way, permanent working capital is similar to the level of water that you find in a bay at low tide.

(b) Briefly explain the significance of working capital management.

- **<u>WORKING CAPITAL MANAGEMENT:</u>**
  Working capital management is essentially an accounting strategy with a focus on the maintenance of a sufficient balance between a company's current assets and liabilities. An effective working capital management system helps businesses not only cover their financial obligations but also boost their earnings.

Significance of working capital management

- Working capital is a daily necessity for businesses, as they require a regular amount of cash to make routine payments, cover unexpected costs, and purchase basic materials used in the production of goods.
- Efficient working capital management helps maintain smooth operations and can also help to improve the company's earnings and profitability. Management of working capital includes inventory management and management of accounts receivables and accounts payables. The main objectives of working capital management include maintaining the working capital operating cycle and ensuring its ordered operation, minimizing the cost of capital spent on the working capital, and maximizing the return on current asset investments.
- Working capital is an easily understandable concept, as it is linked to an individual's cost of living and, therefore can be understood in a more personal way. Individuals need to collect the money that they are owed and maintain a certain amount on a daily basis to cover day-to-day expenses, bills, and other regular expenditures.
- Working capital is a prevalent metric for the efficiency, liquidity and overall health of a company. It is a reflection of the results of various company activities, including revenue collection, debt management, inventory management and payments to suppliers. This is because it includes inventory, accounts payable and receivable, cash, portions of debt due within the period of a year and other short-term accounts.
- The needs for working capital vary from industry to industry, and they can even vary among similar companies. This is due to several factors, including differences in collection and payment policies, the timing of asset purchases, the likelihood of a company writing off some of its past-due accounts receivable, and in some instances, capital-raising efforts a company is undertaking.

- Managing working capital means managing inventories, cash, accounts payable and accounts receivable. An efficient working capital management system often uses key performance ratios, such as the working capital ratio, the inventory turnover ratio and the collection ratio, to help identify areas that require focus in order to maintain liquidity and profitability.