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**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** |

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**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).

* **Cash-flow from Operating Activities:**

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**

* **Cash-flow from Investing Activities:**

Addition to fixed assets ($8)

Proceeds from sales of other assets $5

Net cash provided by investing activities **($3)**

* **Cash-flow from Financing Activities:**

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 **$3**

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?**

If we equate liquidity with “conservativeness,” 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, all other things equal. Policy A is seen as preparing the firm for almost any conceivable current asset need; it is the financial equivalent to wearing a belt and suspenders. Policy C is least liquid and can be labeled “aggressive.” This “lean and mean” policy calls for low levels of cash and marketable securities, receivables, and inventories. We should keep in mind that for every output level there is a minimum level of current assets that the firm needs just to get by. There is a limit to how “lean and mean” a firm can get. We can now summarize the rankings of thealternative working capital policies in respect to liquidity as follows:

**High 🡨-----------🡪 Low**

**Liquidity** Policy A B C

Though policy A clearly provides the highest liquidity, we need to recast the familiar return on investment (ROI) equation as follows:

ROI = Net profit

Total assets

From the condition above we can see that diminishing the measures of current resources held (for instance, a development from Policy A toward Policy C) will expand our expected gainfulness. In the event that we can diminish the company's interest in current resources while as yet having the option to properlysupport yield and deals, ROI will increment. Lower levels of money, receivables, and inventorywould diminish the denominator in the condition; and net benefits, our numerator, would remainroughly the equivalent or maybe even increment. Strategy C, at that point, gives the most elevated profitabilitypotential as estimated by ROI.

Notwithstanding, a development from Policy A toward Policy C brings about different impacts other than expanded benefit. Diminishing money decreases the association's capacity to meet budgetary obligationsas they come due. Diminishing receivables, by embracing stricter credit terms and a tougherenforcement strategy, may bring about some lost clients and deals. Diminishing stock mayalso bring about lost deals because of items being unavailable. In this manner increasingly forceful working capital arrangements lead to expanded hazard. Plainly, Policy C is the most hazardous working capitalpolicy. It is additionally a strategy that accentuates benefit over liquidity. To put it plainly, we can nowmake the accompanying speculations:

**High 🡨--------🡪 Low**

**Liquidity** Policy A B C

**Profitability** C B A

**Risk** C B A

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

* **MATURITY MATCHING:**

Maturity matching or hedging approach is a strategy of working capital financing wherein we finance short term requirements with short-term debts and long-term requirements with long-term debts. The underlying principle is that each asset should be financed with a financial instrument having almost the same maturity.

* EXAMPLE:

To understand it with an example, assume a company bought machinery with a life of 5 Years’ worth $10 million. Let’s assume if there are two options to finance it i.e., issue of 10 Year debenture or apply for cash credit renewable every year. What will you opt for? The obvious answer would be 5 Year Debenture.

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**QUESTION No 4**

**Permanent Working Capital refer to minimum capital investment to be made in current assets. This capital is required in order to carry out the minimum activities of business. Thus it is also known as Regular Working Capital, Core Working Capital or Fixed Working Capital.**

**Example**

**Working capital refers to the money required to fund day-to-day business operations. It can also be used to pay the short-term debt and cover operational expenses.**

**It is the lifeline of any business. Working capital helps the organization function smoothly and carry out its regular operations like payroll payments and paying creditors.**

**PART B**

**SIGNIFICANCE OF WORKING CAPITAL**

**The significance of working capital in a company cannot be exaggerated. A company needs sufficient working capital to run its daily operations efficiently and seamlessly. Inadequate working capital not just impacts the company’s profitability but also prevents production and revenue.**

**Let me give you some instances why working capital is pondered the life-blood of a business:**

**1. Seamless production flow – Sufficient working capital is required to maintain a seamless business production flow.**

**2. Increased reputation – Having a good amount of working capital improves a company’s reputation.**

**3. Improves liquidity & solvency position – Adequate amount of working capital boosts the liquidity and solvency position of a firm.**

**4. Cash discount – Right amount of working capital helps a company avail the benefits of cash discount.**

**5. Hassle-free loan – Working capital makes a better credit-worthiness of a company and as a result, the company can gain an easy  to expand its business by financing.**