MANAGEMENT ACCOUNTING

2 MARKS QUESTIONS WITH ANSWERS

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UNIT 1

1. What is management accounting (or) define management accounting?

ICMA defines Management accounting is the presentation of accounting information in such a way as to assist management in the creation of policy and in the day-to-day operations of an undertaking.

2. Write the objectives of management accounting?

1. To assist the management in promoting efficiency.
2. To prepare budgets covering all functions of a business (i.e., production, sales, research, and finance).
3. To analyses monetary and non-monetary transactions.
4. To compare the actual performance with plan for identifying deviations and their causes.

FINANCIAL STATEMENT ANALYSIS

3. What is meant by financial statement analysis?

"Financial statements" refer to a package of statements such as balance sheet, income statement, funds flow statement, cash flow statement and statement of retained earnings. "Financial statements" reflect a combination of recorded facts, accounting principles and personal judgments'.

4. What is internal analysis?

This analysis is done on the basis of internal and unpublished records. It is done by executives or other authorized official. It is very much useful and significant to employees and management.

5. What is dynamic analysis?

Horizontal analysis is also known as dynamic (or) trend analysis. It is significant for forecasting and budgeting.

6. What is trend percentage?

Horizontal analysis is also known as dynamic (or) trend analysis. Trend analysis is carried out by calculating trend percentages on graph paper (or) chart. It is discloses the changes in financial & operating data between specific periods.

7. What is comparative statement?

Comparative statements usually show the accounting figures for two consecutive periods, revealing any difference between them and its percentage.

8. What is common size statement?

The statements which report the figures as a percentage of some common bases are called common size statements. Sales are taken as the common bases in the common size income statement. Common size statements are useful to a financial analyst. They make comparison easy and meaningful.

RATIO ANALYSIS

1.what are accounting ratios?

- **P&L ratios:**

  Gross profit ratio, net profit ratio, expenses ratio etc.

- **Balance sheet ratios:**

  Current ratio, quick ratio, proprietary ratio etc.

- **Composite ratios (P&L + balance sheet):**

  Debtors & creditors turnover ratio, return on capital employed etc.

2. What is ratio analysis?

Ratio analysis is a tool of management for measuring efficiency and guiding business policies. Ratio analysis is a technique of analysis and interpretation of financial statements. It is the process of determination and interpretation of various ratios for helping in decision making.

3. What is gross profit ratio?

This ratio expresses the relationship between gross profit and net sales.

$$\textbf{G.P. Ratio} = \frac{\textbf{Gross Profit}}{\textbf{Sales}} \times 100$$

It indicates the efficiency of production or trading operations. A high gross profit ratio is a sign of good management as it implies that the cost of production is relatively low.

4. What is net profit ratio?

This ratio measures the relationship between net profit and net sales.

$$\textbf{N.P Ratio} = \frac{\textbf{Net Profit}}{\textbf{Sales}} \times 100$$

It indicates the efficiency of the overall operations of the firm. It shows what percentage of sales is left to the owners after meeting all costs.

5. What is current ratio?

Current ratio is the relationship between current assets and current liabilities. A current ratio of **2:1** is considered ideal.

$$\textbf{Current ratio} = \frac{\textbf{Current assets}}{\textbf{Current liabilities}}$$

6. What is solvency ratio?

Solvency ratio is also called financial ratio, solvency ratio**.** It asses the long term financial condition of the firm.

UNIT 2 FUND FLOW STATEMENT

1. What is fund flow statement?

The fund flow statement is a report on the movement of funds or working capital. It explains how working capital is raised and used during an accounting period.

2. Write any 2 advantages of fund flow statement?

1.Analysis of financial operations.

2.Evaluation of the firm's financing.

3.Allocation of scare resources.

4.Helps in working capital management.

5.Acts as a guide to future

6.Helps financial institutions.

3. How to prepare fund flow statement?

Funds flow statement is usually prepared for one year on the basis of balance sheets and additional information. Preparation of funds flow statement involves the following steps;

1. Schedule of changes in working capital.
2. Opening of accounts for non-current items.
3. Preparation of adjusted profit and loss account.
4. Preparation of funds flow statement.

4. What is fund from operation?

It is the only internal source of funds. All the non-operating expenses and non-operating incomes should be adjusted in the net profit to ascertain funds from statement.

CASH FLOW STATEMENT

5. What is cash flow statement?

Cash flow statement is an important tool of cash planning and control. A statement prepared from the historical data (i.e., income statement and balance sheet) showing sources and uses of cash is called cash flow statement. It reveals the inflow and outflow of cash during the particular period.

6. What is cash from operation?

Cash from operation is a source of cash. It reveals cash generated from routine (or) normal business operations.

WORKING CAPITAL ANALYSIS

7. What is meant by working capital?

. Working capital refers to that part of a firm's capital which is employed for short-term operations. Capital required for purchase of raw materials, and for meeting the day-to-day expenditure on salaries, wages, rents advertising etc., is called working capital.

8. Write the types of working capital?

- Permanent (or) fixed working capital.
- Temporary (or) variable working capital.

9. List out current liabilities?

1.Bank overdrafts.	**4.**Prepaid income.
2.Creditors.	**5.**Outstanding expenses.
3.Bills payable.	**6.**Provision for taxation.

MARGINAL COSTING

1. What is P/V ratio (or) write the formula for profit volume ratio?

This is the ratio of contribution to sales. It is an important ratio analyzing the relationship between sales and contribution. A high P/V ratio indicates high profitability and low P/V ratio indicates low profitability.

$$(1)\ \text{P/V Ratio} = \frac{\text{contribution}}{\text{Sales}}$$

$$= \frac{\text{Sales – variable costs}}{\text{Sales}}$$

$$= \frac{\text{Fixed costs + profit}}{\text{Sales}}$$

$$(2)\ \text{P/V ratio} = \frac{\text{Changes in profit}}{\text{Changes in sales}}$$

2. Define marginal costing?

According to ICMA, England, "Marginal cost is the amount, at any given volume of output, by which aggregate costs are changed, if the volume of output is increased or decreased by one unit".

3. What do you mean by variable cost & Give example?

- These are the costs which increase or decrease in proportion to the output and sales. Variable costs are called "Product costs" (or) "Marginal costs".
- Usually they vary in direct proportion to the output.
- They include all the direct costs (i.e.) direct material, direct wages, direct expenses and variable overheads.
- The variable costs vary in total but they remain constant per unit.

4. What is break - even point (BEP)?

Break - even point refers to the point where total cost is equal to total revenue. It is a point of no profit, no loss. This is also a minimum point of production where total costs are recovered.

(1) Break - even point (in units) = $\dfrac{\textbf{Fixed cost}}{\textbf{Contribution per unit}}$

(2) Break - even point (in rupees) = $\dfrac{\textbf{Fixed cost}}{\textbf{Contribution}} \times \textbf{Sales}$ **(or)** $\dfrac{\textbf{Fixed cost}}{\textbf{PV ratio}}$

5. What is meant by margin of safety (MOS)?

Margin of safety is the excess of sales over the break even sales. It can be expressed in absolute sales amount or in percentage. A large margin of safety indicates the soundness of the business. The formula for the margin of safety is:

MOS = Actual sales – break- even sales

MOS (in units) = $\dfrac{\textbf{Profit}}{\textbf{Contribution per unit}}$

MOS (in rupees) = $\dfrac{\textbf{Profit}}{\textbf{Contribution}} \times \textbf{Sales}$ **(or)** $\dfrac{\textbf{Profit}}{\textbf{PV ratio}}$

6. What is CVP analysis (or) cost volume analysis?

Cost volume profit analysis is the analysis of three variables viz. cost, volume and profit. This analysis measures variations of costs and volume and their impact on profit. Profit is affected by several internal and external factors which influence sales revenue and costs.

<u>UNIT 4</u> BUDGETING & BUDGETARY CONTROL

1. What is budgetary control?

"Budgetary control is a system which uses budgets as a means of planning and controlling all aspects of producing and /or selling commodities and services"

2. Explain the importance of budgetary control?

Budgetary control has become an essential tool of the management for controlling costs and maximizing profits.

- Budgetary control defines the objectives and policies of the undertaking as a whole.
- It helps in estimating the financial needs of the concern. Hence the possibility of under or over capitalization is eliminated.

3. Define the term budget?

A budget is a plan of action expressed in financial terms or non-financial terms. It is prepared for a definite period of time. A budget is a tool which helps the management in planning and control of business activities.

4. What is budgeting?

The entire process of preparing the budgets is known as budgeting. It involves a detailed study of business environment.

5. What is flexible budget?

Flexible budget is also called variable budget. It may be defined as "A budget designed to change in accordance with the level of activity actually attained". It shows estimated costs and profit at different levels of output.

6. What is sales budget?

A sales budget is an estimate of expected sales during the budget period. It may be stated in terms of money or quantity or both. It contains information relating to sales, month-wise, product wise and area wise.

7. What is cash budget?

This budget gives an estimate of receipts and payments of cash during the budget period. It is prepared by the chief accountant. It shows the cash available and needed from time to meet the capital requirements of the organization.

8. What is zero base budgeting?

"Zero base budgeting" was originally developed by peter A.Pyhrr at Texas instruments. A.Pyhrr has defined ZBB as "An operating, planning and budgeting process which requires each manager to justify his entire budget request in detail from zero bases and shifts the burden of proof to each manager to justify why we should spend any money at all."

STANDARD COSTING & VARIABLE ANALYSIS

1. What is standard costing?

Standard costing is, "the preparation and use of standard costs, their comparison with actual cost and analysis of variance to their causes and points of incidence". (ICMA London).

2. How will you calculate material usage variance (MUV)?

It is the difference between the standard quantity specified and the actual quantity used.

MUV = (SQ – AQ) SP

SQ = Standard Quantity

AQ = Actual Quantity

SP = Standard price

UNIT - 5 CAPITAL BUDGETING

1. What is capital budgeting?

- Capital budgeting is the process of making investment decisions regarding capital expenditures. Capital budgeting is also known as long-term planning for investment decisions.
- Charles T.Horngreen has defined capital budgeting as, "A long-term planning for making and financing proposed capital outlays".

2. Write the objectives of capital budgeting?

- Acquiring data relating to possible profitable investment proposals.
- Investigating the technical feasibility and marketing viability of each of proposals.
- Assessing the financial implications and profitability of the proposals.

3. Write the importance of capital budgeting?

Capital budgeting decisions are among the most crucial and critical business decisions. Special care should be taken in making these decisions on account of the following reasons:

1.Heavy investment.
2.Permanent commitment of funds.
3.Long term effect on profitability
4.Irreversible in nature.

4. What is internal rate of return?

Internal rate of return is "that rate of return at which the present values of cash inflows and cash outflows are equal". Thus, at I.R.R the total of discounted cash inflows equals the total of discounted cash outflows. I.R.R discounts the total cash flows to the level of zero.

$$\textbf{At I.R.R} = \frac{\textbf{Cash inflows}}{\textbf{Cash outflows}} = \textbf{1}$$

5. What is ARR (or) Average rate of return?

It is known as accounting rate of return because it takes into account, the accounting concept of profit (i.e. profit after depreciation and tax) and not the cash inflows. The project which yields the highest rate of return is selected.

$$\textbf{ARR} = \frac{\textbf{Average Annual profit}}{\textbf{Original investment}} \times 100$$

(Or)

$$\textbf{ARR} = \frac{\textbf{Average Annual profit}}{\textbf{Average investment}} \times 100$$

$$\textbf{Average Investment} = \frac{\textbf{Original investment}}{2}$$

6. What is PI (or) profitability index?

The profitability index is also called "benefits cost (B/C) ratio". Though this is treated as a separate method due to the importance of results obtained by its usages, it is only a refinement of the N.P.V method.

$$\left.\begin{array}{c}\textbf{Profitability index (P.I)}\\ \textbf{(Or)}\\ \textbf{Benefit cost ratio (B/C)}\end{array}\right\} = \frac{\textbf{Present value of future cash inflows}}{\textbf{Present value of future cash outflows}}$$

7. What is payback period?

"Pay-back period" is the period of time for the cost of a project to be recovered from the additional earnings of the project itself.

$$\textbf{Pay pack period} = \frac{\textbf{Initial investment}}{\textbf{Annual cash inflow}}$$

8. What is net present value (NPV)?

Under this method, present value of cash inflows is calculated at the required rate of return and compared with the original investment. If the present value is higher than the original investment, the project can be selected, otherwise rejected.