MANAGEMENT ACCOUNTING

III B.COM (CA)

SECTION – A (2 MARKS)

1. **What is the meaning of Management Accounting**?

   It refers to accounting for management. It provides necessary information to assist the management in the creation of policy and day-to-day operations. It enables to discharge the all functions.

2. **Definition – Management Accounting.**

"Management Accounting is concerned with accounting information that is useful to the management." - R.N.Anthony.

3. **What is meant by Internal Audit**?

It refers to the establishment of a suitable internal audit system for internal control.

4. **What is the meaning of Financial Statements**?

It refers to a package of statements such as balance sheet, income statement, funds flow statement, cash flow statement and statement of retained earnings.

5. **Define Interpretation**.

It means explaining the meaning and significance of the data so arranged.

6. **Explain Common Size Statements.**

It present absolute figures. A comparison of absolute figures could be misleading.

7. **Discuss Trend Analysis.**

It is very helpful in making a comparative study of the financial statements of several years.

8. **What is meant by Ratio Analysis**?

It is a technique of analysis and interpretation of financial statements. It is the process of determination and interpretation to helping the decision making.

9. **Briefly explain the three steps in ratio analysis**.

Calculation of appropriate ratios, Comparison to ratios in past period and Interpretation of ratios.

10. **Give some details about Profitability Ratios.**

It measures the profitability of a firms' business operations. These ratios may be related to sales or investments.

Dr.M.YASMIN

11. Explain Liquidity Ratios.

It measures the ability of the firm to meet its current obligations. It indicate whether the firm has sufficient liquid resources to meet its short-term liabilities.

12. **What is the meaning of Fund Flow Statement**?

It is a report on the movement of funds or working capital. It explains how working capital is raised and used the accounting period.

13. **Definition – Fund Flow Statement**.

" A statement of sources and application of funds is a technical device designed to analyze the changes in the financial condition of a business enterprise between two dates." – Foulke.

14. **What is the meaning of Cash Flow Statement**?

A statement prepared from the historical data (i.e. Income statement and Balance sheet) showing sources and uses of cash is cash flow statement.

15. **Explain Working Capital**.

Capital required for purchase of raw materials and for meeting the day-to-day expenditure on salaries, wages and advertising.

16. **What is meant by Marginal Costing**?

It reveals the inter-relationship between cost, volume of sales and profit. It guides the management in pricing, decision –making and assessment of profitability.

17. **Marginal Costing – Definition**.

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."

18. **Explain Contribution**. is the difference between sales and variable cost. It contributes towards fixed cost and profits.

19. **Discuss Profit Volume Ratio**.

It may be expressed in percentage. It helps in determining break-even-point, profit at any volume of sales, sales volume required to earn a desired amount of profit.

20. **What is the meaning of Margin of Safety**?

It is the excess of sales over the break even sales. It indicates the extent to which the sales can be reduced without resulting in loss.

Dr.M.YASMIN

21. Briefly explain the Break-Even-point.

It refers to the point where total cost is equal to total revenue. It is a point of no profit, no loss.

22. **What is the meaning of Budget**?

It is a plan of action expressed in financial terms or non-financial terms. It is prepared for a definite period of time. It is a tool which helps the management in purpose of attaining a given objective.

23. **What is the meaning of Budgetary Control**?

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

24. Definition – Budget.

According to ICMA, England," a financial and/or quantitative statement, prepard and approved prior to a defined period of time, of the policy to be pursued during the period for the purpose of attaining a given objective."

25. **Definition – Budgetary Control**.

According to ICMA, England," The establishments of budgets relating the responsibilities of executives to the requirements of a policy and the continuous comparison of actual with budgeted results.

Dr.M.YASMIN

26. **What is meant by Flexible Budget**?

A budget designed to change in accordance with the level of activity accordance attained.

27. Define Zero Base Budgeting.

It assumes that allocation of funds in the pat was correct. To take the previous years' cost levels as a base for preparing this years' budget.

28. What is the meaning of Variance?

It means difference. The difference between the standard cost and actual cost Incurred during a period.

29. Explain Material Cost Variance.

The difference between standard materials cost and actual materials cost. Actual cost is less than the standard cost, the variance is favorable.

30. **Give the expansion and explain MPV**.

MPV means Market Price Variance. It is that part of material cost variance which is due to the difference between the standard cost price specified and the actual price paid.

31. Discuss Labour Mix Variance.

It is the difference between the standard labour grade specified and the actual labour grade utilized.

32. **Give some details about Labour Yield Variance**.

It is a part of labour efficiency variance. It arises due to the difference between standard yield and actual yield.

33. **Give the formula for Material Usage Variance**.

MUV = (Standard Quantity – Actual Quantity) Standard Price

34. **What is the meaning of Capital Budgeting**?

It is the process o making investment decisions regarding capital expenditures.

35. **Definition – Capital Budgeting**.

Charles T.Horngreen defined "A long term planning for making and financing proposed capital outlays."

36. What is the meaning of Pay Back Method?

It is popularly known as pay off or pay out method. It is defined as the number of years required to recover the initial cash outlay invested in a project.

37. Give some details about ARR Method.

It s known as Average Rate of Return because it takes into the account, the accounting concept of profit.

38. **Explain Discounted Cash Flow Method**.

It is an improvement of pay back method. It takes into the account both the profitability and time value of money. It is based on fact that future in time value of money.

39. Discuss IRR.

Internal Rate of Return is the rate of return at which total present value of future cash inflows is equal to initial investment.

40. **Give the formula for Net Present Value**.

Present value of inflows – Present value of outflows

Dr.M.YASMIN

SECTION – B (5 MARKS)

1. **What are the objectives of management accounting?**
   - Promoting efficiency
   - Preparing the budgets
   - Monetary and non-monetary transactions
   - Systematic allocation of responsibilities
   - Formulate fu8ture policies
   - Discharging the responsibilities
2. **Discuss advantages of management accounting**.
   - Helps in decision making
   - Helps in planning
   - Helps in organising
   - Facilitates communication
   - Helps in co-ordinating
   - Evaluation and control of performance
   - Economic appraisal
   - Interpretation of financial information
3. **Explain limitations of management accounting.**
   - Based on accounting information
   - Wide scope
   - Costly
   - Evolutionary stage
   - Opposition to change
   - Intuitive Decisions
   - Not on alternative to management
4. **Distinguish between cost accounting and management accounting.**
   - Objective
   - Scope
   - Data used
   - Nature

Dr.M.YASMIN

5. **What is nature of financial statements?**
   - Recorded facts
   - Accounting principles
   - Personal judgement
6. **What are the uses of ratio analysis**?
   - Simplifies financial statements
   - Helps measuring performance
   - Facilitates intra-firm comparison
   - Facilitates inter-firm comparison
   - Helps in control

7. Discuss limitations of ratio analysis.
   - Inadequacy of standards
   - Limitations of financial statements
   - Problem of price level changes
   - Personal bias
   - No fixed standards

8. **Current ratio 2.5; Working capital Rs.63,000. Calculate current assets and current liabilities**.

   Ans: Current assets – Rs.1, 05, 000 and Current Liabilities – Rs.42,000

Dr.M.YASMIN

9. The following is the trading account of Mr.Murugan. Calculate stock turnover ratio.

	Rs.		Rs.
To Opening stock	15,920	By Sales	78,000
To Purchases	39,000	By Closing stock	14,400
To Carriage	1,000		
To Gross profit	36,480		
	92,400		92,400

Ans: Stock Turnover Ratio – 2.74 times

10. A trader purchases goods both on cash as well as on credit terms. The following Particulars are obtained from the books:

	Rs.
Total Purchases	5,81,000
Cash Purchases	30,000
Purchases Returns	51,000
Creditors at the end	1,05,000
Bills Payable at the end	60,000
Reserve for discount on creditors	8,000

Calculate Average Payment Period.

Ans: Average Payment Period - 120 days

11. From the following details determine the value of debtors:

Total Sales	Rs. 5,00,000	Debtors Velocity	30 days
Cash Sales	Rs. 2,00,000	Bills Receivable	Rs.5,000

Ans: Debtors – Rs.20,000 and Credit Sales – Rs.3,00,000

12. **What are the main objectives of Fund Flow Statement**?
    i) Indicate the results of current position
    ii) How the resources have been used
    iii) General expansion of the business
    iv) Assessment of the working capital position
    v) Distribution of dividend

13. **Explain the items of sources and application of funds.**

Ans: Sources of funds and Uses or Application of funds

14. Give some details about the requirements of working capital depends upon the factors.
    i) Nature of business,
    ii) Size of the business,
    iii) Time consuming,
    iv) Seasonal fluctuations,
    v) Speed of turnover,
    vi) Terms of sales and
    vii) Terms of purchase

Dr.M.YASMIN

5. **Explain the procedure for the preparation of cash Flow Statement.**

i)Opening of Accounts,

ii) Preparation of Adjusted profit & loss a/c,

iii) Comparison of current items to determine inflow and outflow of cash and

iv) Preparation of cash flow statement .

16. **What are the significance and uses of cash flow statement**?

i) Low cash balance and huge profits

ii) Short term financial decisions

iii) Sources and uses of cash

iv) Repayment of loans

v) Understanding the variations

vi) Control of cash expenditure

17. **Differentiate between Permanent working capital and variable working capital**.

a) Amount of Working capital required short periods

b) Business operations

c) Long term sources

d) Minimum level of raw materials

18. **Explain the need or object of working capital**.

a) Conversion of cash into raw materials

b) Raw materials into work-in-progress

c) Work-in-progress into finished goods

d) Finished goods into debtors

e) Debtors into cash

19**. Discuss the importance of working capital**.

a) Continuous production,

b) Solvency and good will,

c) Easy loans,

d) Cash discounts,

e) Regular payment,

f) High return on investments,

g) Exploitation of market conditions.

Dr.M.YASMIN

20. **What are the features of marginal costing**?

1) All costs are classified,

2) Cost of the product,

3) Stock of finished goods,

4) Earning the contribution and

5) Based on price

21. **Write short notes on**:

Fixed cost, Variable cost, Contribution and Margin of safety

22. **Discuss the advantages of Cost Volume Profit analysis**.

1) Preparation of flexible budgets, 2) Forecasting the profits, 3) Evaluating the performance, 4) Formulating price policy, 5) Controlling costs

23. Calculate Break-Even Point from the following particulars:

Fixed expenses Rs.1,50,000

Variable cost per unit Rs.10

Selling price per unit Rs.15

Answer: B.E.P (in units) = 30,000 units

B.E.P (in rupees) = Rs.4,50,000

Dr.M.YASMIN

24. **What are the main objectives of budgetary control**?

i) Goal oriented,

ii) Making the plans,

iii) Co-ordinate the activities,

iv) Eliminate the waste,

v) Estimate the capital expenditure,

vi) Fix the various responsibility

25. **What are the requirements of a good budgetary control system**?

i) Whole hearted support,

ii) Proper fixation of authority,

iii) Realistic and easily attainable,

iv) Not cost to more to operate,

v) To make budgeting successful

26. Prepare a production budget for three months ending March 31, 1999 for a factory producing four products, on the basis of the following information:

Type of Product	Estimated Stock on January 1,1999 Units	Estimated Sales during January - March,1999 Units	Desired Closing Stock March 31,1999 Units
A	2,000	10,000	5,000
B	3,000	15,000	4,000
C	4,000	13,000	3,000
D	5,000	12,000	2,000

Answer : Estimated Production – Rs.13,000, Rs.16,000, Rs.12,000 and Rs.9,000

27**. What are the types of standards?**

a) Ideal Standard,

b) Expected standard,

c) Basic standard,

d) Normal standard

28. **Give the formula for different types of material variance**.

Dr.M.YASMIN

Where AQ = Actual quantity

AP = Actual price

SQ = Standard quantity for the actual output

SP = Standard price

Material Cost Variance

MCV = (AQ X AP) – (SQ X SP)

Material Price Variance

MPV = (AP – SP) x AQ

Material Usage Variance

MUV = (AQ – SQ) x SP

Materials Mix Variance

MMV = (Actual mix – Revised standard mix of actual input) x Standard price

Material Yield Variance

MYV = (Actual yield – Standard Yield specified) x Standard cost per unit

29. **Briefly explain the need and importance of capital budgeting.**

i) Heavy Investment,

ii) Permanent commitment of funds,

iii) Long term effect on profitability,

iv) Irreversible in nature

30. A project Costs Rs.1,00,000 and yields an annual cash inflow of Rs.20,000 for 7 years. Calculate Pay Back Method. **Answer: 5 years**

Dr M YASMIN

SECTION – C (10 MARKS)

1. Distinguish between **Management Accounting and Financial Accounting**.

	Financial accounting	Management accounting
Objectives	Financial accounting is designed to supply information in the form of profit and loss account and balance sheet to external parties like shareholders, creditors, banks, investors and Government.	Management Accounting is designed principally for providing accounting information for internal use of the management..
Analyzing performance	Financial accounting portrays the position of business as a whole.	Management accounting directs its attention to the various divisions, departments of the business and reports about the profitability,

		performance, etc., of each of them.
Data used	Financial accounting is concerned with the monetary record of past events. It is a post-mortem analysis of past activity and, therefore, out the date for management action	Management accounting is accounting for future and, therefore, it supplies data both for present and future duly analyzed in detail in the 'management language' so that it becomes a base for management action
Monetary measurement	In financial accounting only such economic events find place, which can be described in money	Management is equally interested in non-monetary economic events, viz., technical innovations, personnel in the organization, changes in the value of money, etc.
Periodicity of reporting	The Income Statement and the Balance Sheet are usually prepared yearly or in some cases half-yearly	Management requires information at frequent intervals and, therefore, financial accounting fails to cater to the needs of the management.
Precision	financial accounting since the information is meant for internal consumption.	There is less emphasis on precision in case of management accounting
Nature	Financial accounting is more objective while management accounting is more subjective.	Management accounting is fundamentally based on judgement rather than on measurement.
Legal compulsion	Financial accounting has more or less become compulsory for every business on account of the legal provisions of one or the other Act.	A business is free to install or not to install system of management accounting.

Dr.M.YASMIN

2. Explain the Scope and Functions of Management Accounting.

Scope:

Management accounting is concerned with presentation of accounting information in the most useful way for the management. Its scope is, therefore, quite vast and includes within its fold almost all aspects of business operations. However, the following areas can rightly be identified as falling within the ambit of management accounting:

(i) Financial Accounting: Management accounting is mainly concerned with the rearrangement of the information provided by financial accounting. Hence, management cannot obtain full control and coordination of operations without a properly designed financial accounting system.

(ii) Cost Accounting: Standard costing, marginal costing, opportunity cost analysis, differential costing and other cost techniques play a useful role in operation and control of the business undertaking.

(iii) Revaluation Accounting: This is concerned with ensuring that capital is maintained intact in real terms and profit is calculated with this fact in mind.

(iv) Budgetary Control: This includes framing of budgets, comparison of actual performance with the budgeted performance, computation of variances, finding of their causes, etc.

(v) Inventory Control: It includes control over inventory from the time it is acquired till its final disposal.

(vi) Statistical Methods: Graphs, charts, pictorial presentation, index numbers and other statistical methods make the information more impressive and intelligible.

(vii) Interim Reporting: This includes preparation of monthly, quarterly, half-yearly income statements and the related reports, cash flow and funds flow statements, scrap reports, etc. **(viii) Taxation**: This includes computation of income in accordance with the tax laws, filing of returns and making tax payments.

(ix) Office Services: This includes maintenance of proper data processing and other office management services, reporting on best use of mechanical and electronic devices.

(x) Internal Audit: Development of a suitable internal audit system for internal control.

Dr.M.YASMIN

Functions:

The basic function of management accounting is to assist the management in performing its functions effectively. The functions of the management are planning, organizing, directing and controlling.

(i) **Provides data**: Management accounting serves as a vital source of data for management planning. The accounts and documents are a repository of a vast quantity of data about the past progress of the enterprise, which are a must for making forecasts for the future.

(ii) **Modifies data**: The accounting data required for managerial decisions is properly compiled and classified. For example, purchase figures for different months may be classified to know total purchases made during each period product-wise, supplier-wise and territory-wise.

(iii) **Analyses and interprets data**: The accounting data is analyzed meaningfully for effective planning and decision-making. For this purpose the data is presented in a comparative form. Ratios are calculated and likely trends are projected.

(iv) **Serves as a means of communicating**: Management accounting provides a means of communicating management plans upward, downward and outward through the organization. Initially, it means identifying the feasibility and consistency of the various segments of 8the plan. At later stages it keeps all parties informed about the plans that have been agreed upon and their roles in these plans.

(v) **Facilitates control:** Management accounting helps in translating given objectives and strategy into specified goals for attainment by a specified time and secures effective accomplishment of these goals in an efficient manner. All this is made possible through budgetary control and standard costing which is an integral part of management accounting.

(vi) **Uses also qualitative information:** Management accounting does not restrict itself to financial data for helping the management in decision making but also uses such information which may not be capable of being measured in monetary terms. Such information may be collected form special surveys, statistical compilations, engineering records, etc.

Dr.M.YASMIN

3. What are the Limitations of Financial Statements?

i)Personal Bias,

ii) Dependence for basic records,

iii) Management Accounting is only a Tool,

iv) It Provides only Data,

v) Broad based Scope,

vi) Resistance to Change,

vii) Costly to Install and

viii) Evolutionary Stage.

4. Explain how accounting ratios are classified?

Ratios can be classified on the basis of financial statements or on the basis of functional aspects.

A. Classification on the Basis of Financial Statement

i) Balance Sheet Ratios:

Ratios calculated from taking various data from the balance sheet are called balance sheet ratio. For example, current ratio, liquid ratio, capital gearing ratio, debt equity ratio, and proprietary ratio, etc.

ii) Revenue Statement Ratio:

Ratios calculated on the basis of data appearing in the trading account or the profit and loss account are called revenue statement ratios. For example, operating ratio, net profit ratio, gross profit ratio, stock turnover ratio.

iii) Mixed Or Composite Ratio:

When the data from both balance sheet and revenue statements are used, it is called mixed or composite ratio. For example, working capital turnover ratio, inventory turnover ratio, accounts payable turnover ratio, fixed assets turnover ratio, return of net worth ratio, return on investment ratio.

J. YASMIN

Classification of Ratios on the Basis of Financial Statements		
Balance Sheet Ratios	Profit and Loss A/c Ratios	Composite or Mixed Ratios
• Current Ratio • Liquid Ratio • Absolute Liquidity • Ratios • Debt Equity Ratio • Proprietorship Ratio • Capita Gearing Ratio • Assets Proprietorship • Ratio • Capital Inventory to • Working Capital Ratio • Ratio of Current Assets to Fixed Assets	• Gross Profit Ratio • Operating Ratio • Operating Profit Ratio • Net Profit Ratio • Cash Profit Ratio • Expenses Ratio • Interest Coverage Ratio	• Stock Turnover Ratio • Receivable Turnover Ratio • Payable Turnover Ratio • Fixed Assets Turnover Ratio • Total Assets Turnover Ratio • Working Capital turnover Ratio • Capital Turnover Ratio • Return on Capital Employed • Return on Equity Ratio • Return on Shareholders Fund • Capital Turnover Ratio

B. Functional Classification of Ratios

Ratios can be further classified based on their functional aspects as discussed below.

i) **Liquidity Ratios**:

Liquidity ratios are used to find out the short-term paying capacity of a firm, to comment short term solvency of the firm, or to meet its current liabilities. Similarly, turnover ratios are calculated to know the efficiency of liquid resources of the firm, Accounts Receivable (Debtors) Turnover Ratio and Accounts Payable (Creditors).

ii) Long-Term Solvency And Leverage Ratios:

Debt equity ratio and interest coverage ratio are calculated to know the efficiency of a firm to pay long-term debts and to meet interest costs. Leverage ratios are calculated to know the proportion of debt and equity in the financing of a firm.

iii) Activity Ratios:

Activity ratios are also called turnover ratios. Activity ratios measure the efficiency with which the resources of a firm are employed.

iv) Profitability Ratios:

The results of business operations can be calculated through profitability ratios. These ratios can also be used to know the overall performance and

Dr. YASMIN

effectiveness of a firm. Two types of profitability ratios are calculated in relation to sales and investments.

FUNCTIONAL CLASSIFICATION OF RATIOS			
Liquidity Ratios	**Long-term Solvency and Leverage Ratios**	**Activity Ratios Asset management Ratios**	**Profit abilities Ratios**
(A) • Current Ratio • Liquid Ratio • Absolute Liquid or Cash Ratios • Interval Measure (B) • Debtors Turnover Ratio • Creditor Turnover Ratio • Inventory Turnover Ratio	• Debt/ Equity Ratio • Debt to total Capital Ratio • Interest Coverage Ratio • Cash Flow/ Debt • Capital Gearing	• Inventory Turnover Ratio • Debtors Turnover Ratio • Fixed Assets Turn over Ratio • Total Assets Turnover Ratio • Working Capital Turnover Ratio • Payable Turnover Ratio • Capital Employed Turnover Ratio	**(A) In relation to Sales** • Gross Profit Ratio • Operating Ratio • Operative Profit Ratio • Net Profit Ratio • Expenses Ratio **B) In relation to Investments** • Return on Investment • Return on Capital

Dr.M.

5. Describe about the techniques of financial statement analysis.

a) Comparative Statements, b) Common Size Statements and c) Trend Analysis

a) Comparative Statements:

These are the statements showing the profitability and financial position of a firm for different periods of time in a comparative form to give an idea about the position of two or more periods. It usually applies to the two important financial statements, namely, balance sheet and statement of profit and loss prepared in a comparative form. The financial data will be comparative only when same accounting principles are used in preparing these statements. If this is not the case, the deviation in the use of accounting principles should be mentioned as a footnote. Comparative figures indicate the trend and direction of financial position and operating results. This analysis is also known as 'horizontal analysis'.

b) Common Size Statements:

These are the statements which indicate the relationship of different items of a financial statement with a common item by expressing each item as a percentage of that common item. The percentage thus calculated can be easily compared with the results of corresponding percentages of the previous year or of some other firms, as the numbers are brought to common base. Such statements also allow an analyst to compare the operating and financing characteristics of two companies of different sizes in the same industry. Thus, common size statements are useful, both, in intra-firm comparisons over different years and also in making inter-firm comparisons for the same year or for several years. This analysis is also known as 'Vertical analysis'.

c) Trend Analysis:

It is a technique of studying the operational results and financial position over a series of years. Using the previous years' data of a business enterprise, trend analysis can be done to observe the percentage changes over time in the selected data. The trend percentage is the percentage relationship, in which each item of different years bear to the same item in the base year. Trend analysis is important because, with its long run view, it may point to basic changes in the nature of the business. By looking at a trend in a particular ratio, one may find whether the ratio is falling, rising or remaining relatively constant. From this observation, a problem is detected or the sign of good or poor management is detected.

Dr.M.YASMIN

6. From the following details find out (a) Current assets, (b) Current liabilities, (c) Liquid assets and (d) Stock.

Current ratio 2.5; Liquid ratio 1.5; Working capital Rs.1,50,000

Ans : a) Current Assets – Rs.1,50,000, b) Current Liabilities – Rs.60,000,
c) Liquid Assets – Rs.90,000 and d) Stock – Rs.60,000.

7. From the following details prepare statement of Proprietary funds with as many details aas possible:

(i) Stock velocity : 6
(ii) Capital turnover ratio (on cost of sales) : 2
(iii) Fixed assets turnover ratio (on cost of sales) : 4
(iv) Gross profit turnover ratio : 20 per cent

(v) Debtors' velocity : 2 months
(vi) Creditors' velocity : 73 days
The gross profit was Rs.60,000. Reserves and Surplus amount to Rs.20,000. Closing Stock was Rs. 5,000 in excess of opening stock.

Ans : a) Proprietary Funds – Rs.1,20,000, b) Current Liabilities – Rs.49,000,
c) Capital – Rs.1,00,000, d) Reserves – Rs.20,000, e) Debtors – Rs.50,000,
f) Closing Stock – Rs.42,500, g) Other Current Assets – Rs.16,500 and
h) Fixed Assets (Bal. Fig in B/S) – Rs.60,000.

8. From the following ratios are related to the trading activities of National Traders Ltd.,

Debtors' velocity	3 months
Stock velocity	8 months
Creditors' velocity	2 months
Gross profit ratio	25 %

Gross profit was Rs.4,00,000. Closing Stock was Rs. 10,000 in excess of opening stock.
Bills receivable amount to Rs.25, 000 and Bills payable to Rs.10,000.
Find out: (a) Sales (b) Sundry Debtors (c) Closing Stock and (d) Sundry Creditors.

Ans : a) Sales – Rs.16,00,000, b) Debtors – Rs.3,75,000,
d) Closing Stock – Rs.8,05,000, d) Creditors – Rs.1,91,667

Dr.M.YASMIN

9. Discuss the Uses and Limitations of Funds Flow Statement.

Uses:

1. The financial resources of the company are analyzed in detail and disclose the changes made between the two balance sheet dates.

2. It gives an answer to the question of there is an inadequate liquid cash position in spite of business making more and more profits.

3. It shows the extent funds were received the ways of usage for a specific period.

4. It shows the possibility of paying more dividend than current earnings or paying normal dividend in the presence of net loss for the period.

5. The cost of capital of the business can be computed on the basis of the sources of funds flow statement.

6. It shows the usage of earned profits of the current year.

7. The sources of previous year funds flow statement may act as a guide for getting funds for future requirements.

8. Sometimes, the company has high liquid cash position even though, there is a net loss for the specific period. The reason for such position is find out through funds flow statement.

9. The application of funds can provide a basis for selection of investment proposals or future capital expenditure decisions.

10. The overall credit worthiness of the company can find out on seeing the funds flow statement.

11. The strength and weakness of financial position of the company are identified on seeing the funds flow statement.

12. It helps the management to allot the inadequate resources to meet the requirements of business at productive level.

13. It highlights the financial consequences of business operation.

14. It tests the effective use of working capital by the management during a particular period.

15. It helps the management to frame or change the financial policy of the company.

Limitations:

(a) A funds flow statement cannot present a continuous change of financial activities including the changes of working capital.

(b) It is based on financial statement (i.e. Income Statement and Balance Sheet), it is not a original statement.

(c) A projected Funds Flow Statement does not always present very accurate estimates about the financial position since it is a historic one.

(d) It is not a substitute of financial statements, i.e. Income Statement and Balance Sheet. It simply supplies information about the change of Working Capital position which, again, depends on the data presented by the financial statements.

(e) Cash Flow Statement, i.e. changes in cash position, is more important or more informative than the changes in working capital which is presented by a Funds Flow Statement.

10. From the following balance sheets of Apple Ltd. On 31st December, 1998 and 1999 you are required to prepare Funds Flow Statement.

Balance Sheets

Liabilities	1998 Rs.	1999 Rs.	Assets	1998 Rs.	1999 Rs.
Share capital	1,00,000	1,00,000	Goodwill	12,000	12,000
General reserve	14,000	18,000	Building	40,000	36,000
Profit & loss a/c	16,000	13,000	Plant	37,000	36,000
Sundry creditors	8,000	5,400	Investment	10,000	11,000
Bills Payable	1,200	800	Stock	30,000	23,400
Provision for taxation	16,000	18,000	Bills receivable	2,000	3,200
Provision for doubtful debts	400	600	Debtors	18,000	19,000
			Cash	6,600	15,200
	1,55,600	1,55,800		1,55,600	1,55,800

The following additional information has also been given:

(i) Depreciation charged on plant was Rs.4,000 and on building Rs.4,000.

(ii) Provision for taxation of Rs.19,000 was made during the year 1999.

(iii) Interim dividend of Rs.8,000 was paid during the year 1999.

Ans : Increase in Working Capital – Rs.7,000; Fund From Operations – Rs.36,000 and Total of Fund Flow Statement – Rs.36,000

Dr.M.YASMIN

11. What is the difference between Fund Flow Statement and Cash Flow Statement?

Basis of Difference	Funds Flow Statement	Cash Flow Statement
Basis of Analysis	It is based on broader concept i.e. working capital.	It is based on narrow concept i.e. cash, which is only one of the elements of working capital.
Source	It tells about the various sources from where the funds generated with various uses to which they are put.	It stars with the opening balance of cash and reaches to the closing balance of cash by proceeding through sources and uses.
Usage	It is more useful in assessing the long-range	It is useful in understanding the

	financial strategy.	short-term phenomena affecting the liquidity of the business.
Schedule of Changes in Working Capital	In funds flow statement changes in current assets and current liabilities are shown through the schedule of changes in working capital.	In cash flow statement changes in current assets and current liabilities are shown in the cash flow statement itself.
End Result	It shows the causes of changes in net working capital.	It shows the causes the changes in cash.
Principal of Accounting	It is in alignment with the accrual basis of accounting.	In cash flow statement data obtained on accrual basis are converted into cash basis.

Dr.M.YASMIN

12. Balance sheets of Veena Industries Ltd are given below.

Liabilities	31st March 1999 Rs.	31st March 2000 Rs.	Assets	31st March 1999 Rs.	31st March 2000 Rs.
Share capital	10,000	10,000	Goodwill	1,200	1,000
Reserves	1,400	1,800	Building	3,700	3,600
Profit & loss a/c	1,600	1,300	Land	4,000	3,600
Sundry creditors	800	540	Investment	1,000	1,300
Outstanding Exps.	120	80	Stock	3,000	2,340
Provision for Taxation	1,600	1,800	Bills receivable	2,000	2,220
Provision for doubtful debts	40	60	Cash	660	1,520
	15,560	15,580		15,560	15,580

During the year ending 31st March, 2000,

1. A piece of land has been sold for Rs.200.
2. Depreciation amounting to Rs.1,700 has been charged on buildings.
3. Provision for taxation has been made for Rs.1,500 during the year.

Ans : Cash from Operations – Rs.2,360; Building purchased – Rs.1,600
Tax Paid – Rs.1,300; Cash Equivalents – Rs.860.

13. What is meant by Fixed Capital and Working capital? What are difference between the Fixed Capital and Working Capital?

Basis for Comparison	Fixed Capital	Working Capital
Meaning	Fixed capital is the investments done by the business for accruing long-term benefits.	Working capital is the daily requirement pumped into the business.
Acquiring types of assets	Fixed capital is used to acquire non-current assets of the company.	Working capital is used to acquire the current assets of the company.
How liquid it is?	Not at all liquid.	Very much liquid.
Conversion	It can't be converted into cash or kind immediately.	It can be converted into cash or kind immediately.
Term	Serves the business for a long period of time.	Serves the business for a very short period of time.
Accounting period	It offers benefits for more than one accounting period.	It offers benefits for less than one accounting period.
Objective	Strategy-oriented.	Operational.
Consumption	It doesn't directly get consumed by the business but serves the business indirectly.	Business needs working capital to operate.

Dr.M.YASMIN

14. What are the merits and demerits of Marginal Costing?

Advantages of Marginal Costing:

1. The marginal costing technique is very simple to understand and easy to operate.
2. Cost comparisons become meaningful.
3. It provides a more reliable measure for decision-making.
4. It shows more clearly the impact on profit of fluctuations in the volume of sales.
5. Under absorption and over absorption of overheads problems are not arisen under marginal costing.
6. It can be combined with standard costing.
7. The prevailing relationship between cost, selling price and volume are properly explained in clear terms.
8. It shows the relative contributions to profit that are made by each of a number of products and show where the sales effort should be contracted.
9. The management can take short run tactical decisions with the help of marginal costing information.
10. This method helps in optimum allocation of resources and as such it is the most efficient and effective pricing technique and it is useful when demand conditions are slack.

Disadvantages of Marginal Costing

1. The total costs cannot be easily segregated into fixed costs and variable costs.
2. It is also very difficult to per-determine the degree of variability of semi-variable costs.
3. The fixed costs do not remain constant and the variable costs are not varying according to level of output.
4. There is no meaning in the exclusion of fixed costs from the valuation of finished goods.
5. Tax authorities do not accept the valuation of stock.
6. The calculation of variable overheads does not include all the variable overheads.
7. Preparation of periodic operating statements becomes unrealistic.
8. The elimination of fixed costs renders cost comparison of jobs difficult.
9. The management cannot take a quality decision.
10. The fixed costs are constant only for short period. In the long run, all the costs are variable.

15. From the following information relating to Quick Standards Ltd., you are required to find out a) P.V ratio, b) Break-Even point, c) Profit, d) Margin of safety

Total Fixed Costs Rs.4,500

Total Variable Costs Rs.7,500

Total Sales Rs.15,000

e) Also Calculate the volume of sales to earn profit of Rs.6,000.

Ans : a) P.V ratio – 50%, b) Break-Even Sales – Rs.9,000, c) Profit – Rs.3,000, d) Margin of Safety – Rs.6,000 and e) Sales required to earn Profit - Rs.21,000.

16. Assuming that the cost structure and selling price remain the same in periods I and II find out:

a) P/V ratio

ii) B.E.Sales

iii) Profit when sales are Rs.1,20,000

iv) Sales required to earn a profit of Rs.40,000

v) Fixed Expenses

Period	Sales	Profit
	Rs.	Rs.
I	1,40,000	15,000
II	1,60,000	20,000

Dr.M.YASMIN

Ans : a**) P.V ratio – 25%, b) Break-Even Sales – Rs.80,000, c) Profit – Rs.10,000, d)Fixed Expenses – Rs.20,000, Contribution – Rs.30,000 and e) Sales requir to earn Profit - Rs.2,40,000.**

17. Discuss the advantages and disadvantages of Budgetary Control.

A document which sets out, inter alias, the responsibilities of the persons engaged in, the routine of and forms and records required for budgetary control.

Advantages:

1. Maximization of Profits:

2. Co-ordination:

3. Specific Aims:

4. Tool for Measuring Performance:

5. Economy:

6. Determining Weaknesses:

7. Corrective Action:

8. Consciousness:

9. Reduces Costs:

10. Introduction of Incentive Schemes

Limitations:

1. Uncertain Future:
2. Budgetary Revision Required:
3. Discourage Efficient Persons:
4. Problem of Co-ordination:
5. Conflict Among Different Departments:
6. Depends Upon Support of Top Management:

18. Briefly explain the different types of budgets.

Some of types of Budgets are: (i) Sales Budget (ii) Production budget (iii) Financial budget (iv) Overheads budget (v) Personnel budget and (vi) Master budget!

(i) Sales Budget:

A sales budget is an estimate of expected total sales revenue and selling expenses of the firm. It is known as a nerve centre or backbone of the enterprise. It is the starting point on which other budgets are also based. It is a forecasting of sales for the period both in quantity and value. It shows what product will be sold, in what quantities, and at what prices.

Some of these factors are:

(i) Past sales figures and trend ;

(ii) Estimates and reports by salesmen ;

(iii) General economic conditions ;

(iv) Orders in hand ;

(v) Seasonal fluctuations ;

(vi) Competition ; and

(vii) Government's control.

(ii) Production budget:

Production budget is prepared on the basis of the sales budget. But it also takes into account the stock levels required to be maintained. It contains the manufacturing programmes of the enterprise. It is helpful in anticipating the cost of production.

It is made by the production manager keeping in mind the following important factors:

(i) The sales budget

(ii) Plant capacity;

(iii) Inventory policy and

(iv) Availability of raw-materials, labour, power, etc.

The production budget is often divided into several budgets:

(i) Material Budget- which fixes the quantity, quality and cost of raw materials needed for uninterrupted production ;

(ii) Labour Budget-which specifies the requirements of labour in terms of the number and type of workers for various jobs ;

(iii) Plant and equipment Budget- which lays down the needs of machines, equipment and tools including their repairs and maintenance ; and

(iv) Research and Development Budget-which specifies the estimated cost on research and development for developing new products and for improving existing ones.

(iii) Financial budget:

This budget shows the requirement of capital for both long-term and short-term needs of the enterprise at various points of time in future. Its objective is to ensure regular supply of adequate funds at the right time. An important part of the financial budget is the cash budget.

Cash budget contains estimated receipts and payments of cash over the specified future period. It serves as an effective device for control and coordination of activities that involves receipt and payment of cash. It helps to detect possible shortage or excess

of cash in business. The financial budget also contains estimates of the firm's profits and expenditure i.e., the operating budget.

(iv) Overheads budget:

It includes the estimated costs of indirect materials, indirect labour and indirect factory expenses needed during the budget period for the attainment of budgeted production targets. This budget is prepared on departmental basis for effective control over costs. The factory or manufacturing overheads can be divided into three categories: (i) fixed, (ii) variable, (iii) semi-variable. This classification helps in the formulation of overhead budgets for each department.

(v) Personnel budget:

It lays down manpower requirements of all departments for the budget period. It shows labour requirements in terms of labour hours, cost and grade of workers. It facilitates the personnel managers in providing required number of workers to the departments either by transfers or by new appointments.

(vi) Master budget:

It is a summarised budget incorporating all functional budgets. It projects a comprehensive picture of the proposed activities and anticipated results during the budget period. It must be approved by the top management of the enterprise. Though practices differ, a master budget generally includes, sales, production, costs-materials, labour, factory overhead, profit, appropriation of profit and major financial ratios.

19. What are the advantages of Zero Base Budgeting?

A budget is nothing but the expression of objectives of an organization in numerical terms. A budget can be effectively used as a managerial control if input of an activity has a direct relation with the output of these activities.

Advantages of Zero based budgeting

The following are the advantages of ZBB.

1. It is highly useful to non-profit or service organizations.
2. Costs may be saved in inefficient operations.
3. Since the resources are allocated on cost benefit terms, there is a better utilization of resources.

4. It forces the management executives at all levels for active participation in budgeting process.

5. It ensures careful planning.

6. The finance manger gives a clear picture about the extent of finance available and the consequences of raising the finance.

7. It does not carry any inefficiency and forward the same to next year.

8. It promotes operational efficiency since it is not based on incremental approach.

Disadvantages of Zero based budgeting

The following are the disadvantages of ZBB.

1. In the case of large-scale business organization, a number of decision packages are prepared and it involves more expenses.

2. It is a time consuming process.

3. More paper work is involved in the preparation of ZBB.

4. Managers can be threatened by zero based budgeting.

5. The manager may develop fear and oppose new ideas and changes.

6. There is personal bias in the ranking of decision packages.

7. Administration and communication of ZBB may create many critical problems.

20. BPL Ltd.wishes to arrange overdraft facilities with its bankers during the period April to June 2000 when it will be manufacturing mostly for stock. Prepare a cash budget for the above period from the following data. Indicating the extent of the bank facilities the company will require at the end of each month.

a)

	Credit Sales	Purchases	Wages
	Rs.	Rs.	Rs.
February 2000	1,80,000	1,24,800	12,000
March	1,92,000	1,44,000	14,000
April	1,08,000	2,43,000	11,000
May	1,74,000	2,46,000	10,000
June	1,26,000	2,68,000	15,000

b) 50 per cent of credit sales are realized in the month following the sales and the remaining 50 per cent in the second month following. Creditors are paid in the month following the month of purchase.

c) Cash at bank on 1-4-2000 (estimated) Rs.25,000.

Ans : Closing Balances: April – Rs.56,000; May – Rs.47,000(O.D);

June – Rs.1,67,000(O.D)

21. What are the types of Variances? Explain.

It may be grouped into three categories as under:

1. Material Cost Variance (MCV),
2. Labour Cost Variance (LCV),
3. Overhead Cost Variance (OCV).

1. Material Variances may be various types as under:

i. Material Cost Variance.

ii. Material Price Variance.

iii. Material usage Variance.

iv. Material yield Variance.

v. Material Mix Variance.

vi. Material Revised (Sub usage) Variance.

2. Labour variances are of various types as under:

i. Labour cost variance

ii. Labour rate variance

iii. Labour efficiency

iv. Revised variance

v. Idle item variance

vi. Calender variance.

3. Overhead Variances:

i. Variable overheads

ii. Fixed overheads.

i. Variable Overhead Variance:

The variable overheads are those cost which tend to vary in proportion of Volume of Production. The standard cost per unit will remain the same.

a. Variable Overhead Expenditure Variance:

b. Variable Overhead Cost Variance:

c. Variable Overhead Revised Expenditure Variance:

d. Variable Overhead Efficiency Variance**:**

ii. Fixed Overhead Variances:

a. Overhead Cost Variance:

(i) On the Basis of Units of Output:

(ii) On the Basis of Standard Hours:

b. Fixed overhead Expenditure Variance:

c. Fixed overhead Volume Variance:

(i) On the Basis Units of Output:

(ii) On the Basis of Standard Hours:

22. The standard material and standard cost per kg. of material required for the production of one unit of product A is as follows:

Material - 5 Kgs.

Standard price - RS.5 per kg.

The actual production and related material data are as follows:

100 units of product A

Material used 2,200 kgs

Price of material Rs.4.50 per kg.

Calculate (1) Material Cost Variance

(2) Material Usage Variance

(3) Material Price Variance

Dr.M.YASMIN

Ans : (a) M.C.V – Rs.100(F); (b) M.U.V – Rs.1,000(A); (c) M.P.V – Rs.1,100(F);

Standard Quantity – 2,000 kgs.

23. What are the importances of Capital Budgeting?

It is a process that helps in planning the investment projects of an organization in long run. It takes all possible consideration into account so that the company can evaluate the profitability of the project. It is useful for evaluating capital investment project such as purchasing equipment, the rebuilding of equipment etc.

Importance:

Large Investments

Involvement of a Large Number of Funds

Irreversible Decision

Monitoring & Controlling the Expenditure

Transfer of Information

Difficulties of Investment Decision

Maximization of Wealth

24. The following are the cash inflows and outflows of a certain project.

Year	Outflows	Inflows
0	1,50,000	
1	30,000	30,000
2		30,000
3		50,000
4		60,000
5		40,000

The salvage value at the end of 5 years is RS.40,000. Taking the cut off rate as 10%, calculate Net Present Value.

Year	1	2	3	4	5
P.V.factor @10%	0.909	0.826	0.751	0.683	0.621

Ans : NPV – Rs.2,990; PV of Cash Inflows – Rs.1,80,260;

PV of Cash Outflows – Rs.1,77,270.

YASMIN

25. What are the techniques to be used in Capital Budgeting?

There are different methods adopted for capital budgeting. The traditional methods or non discount methods include: Payback period and Accounting rate of return method. The discounted cash flow method includes the NPV method, profitability index method and IRR.

- **Payback Period Method:**

This method refers to the period in which the proposal will generate cash to recover the initial investment made. It purely emphasizes on the cash inflows, economic life of the project and the investment made in the project, with no consideration to time value of money.

Payback period = Cash outlay (investment) / Annual cash inflow

- **Accounting Rate of Return Method (ARR):**

This method helps to overcome the disadvantages of the payback period method. The rate of return is expressed as a percentage of the earnings of the investment in a particular project. It works on the criteria that any project having ARR higher than the minimum rate established by the management will be considered and those below the predetermined rate are rejected.

ARR= Average income/Average Investment

- **Discounted Cash Flow Method:**

The discounted cash flow technique calculates the cash inflow and outflow through the life of an asset. These are then discounted through a discounting factor. The discounted cash inflows and outflows are then compared. This technique takes into account the interest factor and the return after the payback period.

- **Net present Value (NPV) Method:**

This is one of the widely used methods for evaluating capital investment proposals. In this technique the cash inflow that is expected at different periods of time is discounted at a particular rate. The present values of the cash inflow are compared to the original investment. If the difference between them is positive (+) then it is accepted or otherwise rejected. This method considers the time value of money and is consistent with the objective of maximizing profits for the owners. However, understanding the concept of cost of capital is not an easy task.

NPV = PVB – PVC

where,

PVB = Present value of benefits

PVC = Present value of Costs

- **Internal Rate of Return (IRR):**

This is defined as the rate at which the net present value of the investment is zero. The discounted cash inflow is equal to the discounted cash outflow. This method also considers time value of money. It tries to arrive to a rate of interest at which funds invested in the project could be repaid out of the cash inflows. However, computation of IRR is a

tedious task. It is called internal rate because it depends solely on the outlay and proceeds associated with the project and not any rate determined outside the investment.

If IRR > WACC then the project is profitable.

If IRR > k = accept

If IR < k = reject

- **Profitability Index (PI):**

  It is the ratio of the present value of future cash benefits, at the required rate of return to the initial cash outflow of the investment. It may be gross or net, net being simply gross minus one. The formula to calculate profitability index (PI) or benefit cost (BC) ratio is as follows.

PI = PV cash inflows/Initial cash outlay A,

PI = NPV (benefits) / NPV (Costs)

All projects with PI > 1.0 is accepted.

Dr.M.