Unit-1

MANAGEMENT ACCOUNTING

Two Mark Questions:-

1) **Define Management Accounting.**
   According to ICMA "Management accounting is the presentation of accounting information in such way as to assist management in the creation of policy and in the day-to-day operations of an undertaking."
2) **Give any two objectives of management accounting.**
   1. **Measuring performance: Management accounting measures two types of performance. First is employee performance and the second is efficiency measurement. The actual performance is measured with the standardized performance and a report of deviation from the standard performance is reported to the management for the effective decision making and also to indicate the effectiveness of the methods in use. Both types of performance management are used to make corrective actions in order to improve performance.**
   2. **Assess Risk: The aim of management accounting is to assess risk in order to maximize risk.**
   3. **Allocation of Resources: is an important objective of Management accounting.**
   4. **Presentation of various financial statements to the Management.**
3) **Mention any two advantages of management accounting.**
   Advantages of Management Accounting:

1. It helps to increase the efficiency of all functions of management.
2. It helps in target-fixing, decision-making, price-fixing, selection of product-mix and so on.
3. Forecasting and Budgeting help the concerns to plan the future and financial activities.
4. Various tools and techniques provide reliability and authenticity to carry out the business functions.

FIVE MARK QUESTIONS:-

1) Explain the objectives of management accounting.

Objectives of Management Accounting:

Management accounting can be defined as an accounting under which management uses the accounting information for making future decisions. Here is the list of objectives of management accounting-

1. Planning: The success of any business depends upon the proper planning. Planning also involves foreseeing the problem of arranging adequate funds or resources implement the various plans. It can render valuable information as to what should the cheapest source in terms of cost involved.
2. Organizing: By following various techniques of it, each department of the organization can be examined separately. It helps the management in performing this function by assigning specific responsibilities to different people.
3. Controlling: Management Accounting helps the management in controlling the performance of the business. The actual results are compared to plan objectives. Budgetary control, cost variance, and

interpretation of financial statements are helpful in this direction.

4. **Decision making: Decision-making is a very important function of management among all the functions of the management. It can be very helpful in this regard. Under this function, to management finds various alternatives, which should yield maximum profit. Marginal Costing, break-even analysis etc. can help to the management in this regard.**
5. **Time saving: It is concerned with the analysis and interpretation of financial statements. It selects only that information, which is useful to managements and hence save the time of the managements.**

2) Distinguish between Management Accounting and Cost Accounting.

Basis	Management Accounting	Cost Accounting
1. Purpose	To provide information to management.	To ascertain and control costs.
2. Nature	It deals with future projections and plans on the basis of past and present cost data.	It is based on past and present facts and figures.
3. Principles	No principle is followed.	Certain principles are followed in the system of costing.
4. Data used	Both quantitative and qualitative information are recorded.	Only quantitative aspect is recorded.

5. Users	Used by the management only.	Used by both internal parties and external parties.

TEN MARK QUESTIONS:-

1) **Explain the advantages of Management accounting.**
   Explain managerial uses of management accounting.

Advantages of Management Accounting

1. It helps to increase the efficiency of all functions of management.
2. It helps in target-fixing, decision-making, price-fixing, selection of product-mix and so on.
3. Forecasting and Budgeting help the concern to plan the future and financial activities.
4. Various tools and techniques provide reliability and authenticity to carry out the business functions.
5. It is useful in controlling wastage and defects.
6. It helps in complete communication between all levels of management.
7. It helps in controlling the cost of production thus increasing the profit percentage.
8. It is proactive-analyses the governmental policies and socio-economic scenario which helps to assess the external environmental impacts on the organization.

UNIT – 2

ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS

TWO MARK QUESTIONS:-

1. **What are financial statements?**
   What do you mean by Financial Statement?
   Financial Statements refer to formal and original statements prepared by a business concern to disclose its financial information. They are Profit and loss account and Balance sheet. They disclose the results of the business during a period and the financial position of the business respectively.
2. **What are the parties interested in the interpretation of financial statement?**
   Who requires financial statements?
   Parties Interested In Financial Statement Analysis:
   The analysis of financial figures contained in the company's profit and loss account and balance sheet by employing appropriate technique is known a financial statement analysis. Financial statement analysis is useful to different parties interested in financial statement analysis.
   1) **Shareholders**
      Shareholders are interested in financial statement analysis to know the profitability of the organization. Profitability shows the growth potentially of an organization and safety of investment of shareholders.
   2) **Investors and Lenders**
      Investors and lenders are interested to know the solvency position of an organization. They analyse the financial

statement position to know about the safety of their investment and ability to pay interest and repayment of principle amount on due date.

3) Creditors

Creditors are interested in analysing the financial statements in order to know the short term liquidity position of an organization. Creditors analyse the financial statement to know whether the organization is able to pay the amount of short term liabilities on due date.

4) Management

Management is interested to analyse the financial statement for measuring the effectiveness of its policies and decisions. It analyse the financial statements to know short term and long term solvency position, profitability, liquidity position and return on investment from the business.

5) Government

Government is interested to analyse the financial position in determining the amount of tax liability. It also helps for formulating effective plans and policies for economic growth.

3. What is 'Internal Analysis'?

The analysis done by executive or other authorised officials based on the unpublished records is known as 'Internal Analysis'. It is very much useful to employees and management.

4. What is Common-size Statement?

Common-size statements indicate the relationship of various items with some common items. In the common-size income statements, the sales figure is taken as basis and all other figures are expressed as percentage of sales. Similarly, in the

common-size Balance sheet, the total assets and total liabilities are taken as base and all other figures are expressed as percentage of these totals.

5. What is 'Comparative financial statements'?
   Comparative financial statements refer to those statements which summarize and present accounting data for a number of years incorporating therein changes in individual items of financial statements. These statements mainly include Comparative Balance sheet and Comparative income statement.

FIVE MARK QUESTIONS:- (THEORY)

1. What are the objectives of analysis and interpretation of financial statements?
   Discuss the objectives of financial statement analysis.
   1) To interpret the profitability and efficiency of various business activities help of income statement.
   2) To aid in investment decisions and financial decisions.
   3) To identify the areas of mismanagement and potential danger.
   4) To ascertain the investment pattern of the resources.
   5) To ascertain the maintenance of financial leverage.
   6) To determine the pattern of movement of inventory.
   7) To identify the diversion of funds, if any.
   8) To measure the utilisation various assets during the period.
   9) To decide about the future prospects of the firm.
   10) To compare operational efficiency of similar concerns.
2. What are the limitations of financial statements?
   1) Information shown in financial statements is not precise since it is based on practical experience, the conventions and rules developed there form.

2) Financial statements do not always disclose the correct financial position of business concerns as they are influenced by the personal opinions, judgement, subjective views and whims of accountants of each concern.
3) Balance sheet of a concern is a static document as it discloses the financial position of a concern on a particular date. But the values shown and composition of items keep changing day-by-day. Therefore, the data and information does not disclose current realities.
4) Information disclosed by profit and loss account may not be real as many items shown in the profit and loss account are not real but estimated.
5) Financial statements are ‘dumb,’ because they cannot speak themselves. The statements require further detailed analysis and interpretation.
6) Financial statements of one period may not be comparable as such with statements of other periods due to differences in conditions and changes in economic situation. Statements of one concern cannot be compared with those of other concerns as the accounting practices differ.
7) Financial statements do not disclose the contribution of man towards the efficiency of business. The ability, energy and efficiency of the management are mainly responsible for the success of a business, but the monetary value of which is not disclosed in the financial statements.

UNIT – 3

RATIO ANALYSIS

TWO MARK QUESTIONS:- (THEEORY)

1. **Define the term Ratio.**
   Ratio can be defined as, "Relationships expressed in quantitative terms, between figures which have cause and effect relationships or which are connected with each other in some manner or the other."
2. **What is Ratio analysis?**
   The Process of consumption of accounting ratios and interpreting them with the intention of supply of useful information to the management is known as Ratio Analysis.
3. **What is current ratio?**
   State the meaning of Current Ratio.
   The current ratio is a financial ratio that shows the proportion of current assets to current liabilities. The current ratio is used as an indicator of a company's liquidity. In other words, a large amount of current assets in relationships to a small amount of current liabilities provides some assurance that the obligations coming due will be paid.
4. **Write a short note on leverage.**
   Financial leverage refers to the use of debt to acquire additional assets. Financial leverage is also known as trading on equity.
5. **What is capital structure?**
   The capital structure is how a firm finances its overall operations and growth by using different sources of funds. Debt comes in the form of bond issues or long-term notes

payable, while equity is classified as common stock, preferred stock or retained earnings.

6. **What is Profitability Ratio?**

   A profitability ratio is a measure of profitability, which is a way to measure a company's performance. Profitability is simply the capacity to make a profit, and a profit is what is left over from income earned after you have deducted all costs and expenses related to earning the income.

7. **What is solvency ratio?**

   Definition of 'Solvency Ratio' A key metric used to measure an enterprise's ability to meet its debt and other obligations. The solvency ratio indicates whether a company's cash flow is sufficient to meet its short-term and long-term liabilities.

   Solvency ratio or financial ratio

   Short term solvency ratio:

   a. **Current ratio = current assets / current liability**
   b. **Liquid ratio = liquid asset / current liability or liquid ratio**
   c. **Cash position ratio = Cash and bank balance + marketable securities / current liability**

      Long term solvency ratios:

      a. **Fixed asset ratio = fixed asset / long term fund**
      b. **Debt equity ratio = long term debt / shareholders fund**
      c. **Proprietary ratio = shareholders fund / total tangible assets**

8. **What is Operating Ratio?**

   Definition of 'Operating Ratio" A ratio that shows the efficiency of a company's management by comparing operating expense to net sales.

9. **Write down the formula for capital gearing ratio.**

Capital Gearing Ratio = Equity Share Capital / Fixed Capital Bearing Funds.

TEN MARK QUESTIONS:- (THEORY)

1. **Bring out the limitation of 'Ratio analysis".**
   Explain the Advantages and Limitations of Ratio Analysis.
   Advantages of Ratio Analysis:
   1) **Forecasting: Ratios reveal trends in costs, sales, profits and other inter-related facts, which will be helpful in forecasting future events.**
   2) **Facilitates Communication and Managerial control: Ratios facilitate the communication of management as they convey the information relating to the present and future quickly, forcefully ad clearly. Ratios can also be used as 'instrument of control' regarding sales, costs and profit.**
   3) **Measuring Efficiency: Ratios help to know the operational efficiency by comparison of present ratios with those of the past and also with those of other firms in the industry.**
   4) **Facilitates investment Decisions: ratios are helpful in computing return on investment. This helps the management in exercising effective decisions regarding profitable avenues of investment.**
   5) **Useful in measuring financial solvency: the financial statements disclose the assets**

and liabilities in a format. But they do not convey relationship of various assets and liabilities with each other, whereas ratios indicate the liquidity position of the concern and the proportion of borrowed funds to total resources which reveal the short-term and log-term solvency position of a firm.

Limitations of Ratio analysis:

1) Requires Practical Knowledge: the analyst should have through knowledge and experience about the firm and industry.
2) Means but not the end: Ratios are not an end in themselves but they are means achieve a particular purpose or end.
3) Inter-relationship: ratios are inter-related and therefore a single ratio cannot convey any meaning. It has to be interpreted with reference to other related ratios to draw meaningful conclusions.
4) Non-availability of standards or norms: Ratios will be meaningful if they can be compared with standards or norms. Except for a few financial ratios, other ratios lack universally recognised standards.
5) Dependence on the accuracy of financial statements: the accuracy of a ratio depends on the accuracy of information derived from financial statements. If the statements are inaccurate, same will be reflected in the ratios.

UNIT – 4

FUNDS FLOW AND CASH FLOWS STATEMENTS

TWO MARK QUESTIONS:-

1) **What is "Funds Flow Statement"? or**
   Define Funds Flow Statement.
   It is a statement showing the Inflows (Source) and Outflows (Applications) of working capital during a particular period.
2) **What is Funds from Operations?**
   All Non-fund items or Non-operating incomes should be adjusted in the Net Profit to ascertain funds from operations. It is the actual amount generated from the operations of the business. It is the only internal source of funds.
3) **What is "Cash Flow Statement as per AS-3"?**
   It is a statement showing the Inflows (Receipts) and Outflows (Payments) of cash and its equivalents during a particular period. It reports the cash receipts and payments classified according to the firm's major activities-Operating, Investing and Financing.
4) **What is Cash flow analysis?**
   An examination of a company's cash inflows and outflows during a specific period. The analysis begins with a starting balance and generates an ending balance after accounting for all cash receipts and paid expenses during the period. The cash flow analysis is often used for financial reporting purposes.
5) **What is Working Capital?**

Definition of ‘ Working Capital”.

Working Capital is a measure of both a company’s efficiency and its short-term financial health. Working Capital is calculated as:

Working Capital = Current Assets – Current Liabilities

6) **Explain the term budget?**

A budget is the monetary and or quantitative expression of business plans and policies to be pursued in the future period of time.

7) **Define the term “budget”.**

ICMA defines a budget as “A financial and or quantitative statement, prepared prior to a defined period of time, of the policy to be pursued during that period for the purpose of attaining a given objective.”

8) **Define “Budgetary Control”?**

ICMA defines budgetary control as “the establishment of budgets, relating the responsibilities of executive to the requirements of a policy, and the continuous comparison of actual with budgeted results either to secure by individual action the objectives of that policy or to provide a basis for its revision”.

FIVE MARK QUESTIONS:-

1. **Distinguish between “Funds Flow Statement” and “Cash Flow Statement”.**

S.No	Basis	Funds Flow Statement	Cash Flow Statement
1.	Basis of preparation	It is based on working capital concept of funds.	It is based on cash concept of funds.

2.	Usefulness	It is more useful for making decisions in the long-run.	It is more useful in the short run.
3.	Short-term Solvency	It is a better indicator of short-term solvency because it considers all the current assets and current liabilities.	It cannot clearly reveal the short-term solvency position of a firm because it considers only cash and ignores all other current assets and current liabilities.
4.	Activity-wise Classification	Sources and uses of funds are not classified activity-wise.	Cash inflows and outflows are segregated into those from operating, Investing and Financing activities.
5.	Preparation of budgets	It is an important tool for the preparation of capital expenditure budget particularly for the medium term.	It is very useful to make the short term estimates of cash for the preparation of cash budget.

2) What are the main functions of Budget Committee?

The principal functions of the budget committee are to:

1. **Decide the company's general policies and objectives;**
2. **Receive ad review individual budget estimates concerning different departments/units/divisions;**
3. **Suggest changes, modifications in accordance with organisational objectives;**
4. **Approve budgets which act as an authority/target for departmental action;**
5. **Receive ad analyse performance reports regarding the implementation of budgets;**
6. **Suggest corrective action to improve efficiency and achieve budgetary goals.**

Unit – 5

CAPITAL EXPENDITURE CONTROL

TWO MARK QUESTIONS:-

1. **Define "Capital Budgeting".**
   According to Herold Beirman Jr. and T.R.Dyckman J.Gitman, "Capital budgeting is the process of deciding whether or not to commit resources to projects whose costs and benefits are spread over several time periods."
2. **What is "Pay-Back Period"?**
   It is the period within which investment in fixed assets or projects can be recovered. It is also known as "Pay-out Period" or "Pay-off Period".
3. **Expand:**
   a) **NPV**
   b) **ARR**
   c) **IRR**
   d) **PI**

   Net Present Value (NPV),

   Average Rate of Return (ARR),

   Internal Rate of Return (IRR),

   Profitability Index (PI).

4. **Give any two merits of pay-back period.**
   Advantages of Pay Back Period (PBP)
   1) **Payback period is simple and easy to understand and compute.**
   2) **Payback period is universally used and easy to understand.**

3) **Payback period gives more importance on liquidity for making decisions about the investment proposals.**
4) **Payback period deals with risk. The project with a shortest PBP has less risk than with the project with longest PBP.**
5) **The short term approach of payback period is an added advantage of calculation of capital expenditure.**

5. **What is Net Present Value method?**
   Net Present Value method (also known as discounted cash flow method) is a popular capital budgeting technique that takes into account the time value of money. It uses net present value of the investment project as the base to accept or reject a proposed investment in projects like purchase of new equipment, purchase of inventory, expansion or addition of existing plant assets and the installation of new plants etc.
6. **Define "Capital Expenditure".**
   A capital expenditure is an amount spent to acquire or improve a long-term asset such as equipment or buildings. Usually the cost is recorded in an account classified as property, Plant and Equipment. The cost (except for the cost of land) will then be charged to depreciation expense over the useful life of the asset.
7. **What is Average Rate of Return?**
   Method of investment appraisal which determines return on investment by totalling the cash flows (over the years for which the money was invested) and dividing that amount by the number of years.

FIVE MARK QUESTIONS:-

1. **What are the features of Capital Budgeting?**
   1) **Capital budgeting entails heavy investment of funds; it may run into lakhs and crores of rupees.**

2) Capital expenditure once approved represents long-term investments that cannot be reversed or withdrawn without sustaining a loss.

3) Preparation of capital budget plans involves forecasting of several years profits in advance in order to judge the profitability of projects.

4) The effect of capital budgeting decisions – judicious or faulty goes to several years subsequent to the year of expenditure. A capital budget, thus, looks to have much longer range future than other budgets do.

5) There is greater uncertainty of the results. Although every decision has an element of uncertainty, the element of uncertainty is much more potent here, since capital budgeting concerns distant future.

2. What are the Advantages of Pay-Back Period method?

1) It is simple to understand and easy to calculate.

2) Inherently, the method provides for uncertainty. Dealing with risk is a 'Built-in' feature of this method. Its focus on recovery of investment takes care of uncertainty and risk to a great extent.

3) Loss through obsolescence is minimized because short-term projects are preferred through lower pay-back period criterion.

4) Profit is recognised only after the pay-back period. So, it acts as a guideline for dividend policy in the case of new firms.

5) The importance given to liquidity through the emphasis on early returns from projects will enable a firm to manage with lower funds.