

Mineral based industrie essay sample



Q1What are the limitations of management accounting

Answer

Limitations of Management Accounting

Management accounting, being comparatively a new discipline, suffers from certain limitations, which limit its effectiveness. These limitations are as follows:

- (i) Limitations of basic records: Management accounting derives its information from financial accounting, cost accounting and other records. The strength and weakness of the management accounting depends upon the strength and weakness of these basic records. In other words, their limitations are also the limitations of management accounting.
- (ii) Persistent efforts: The conclusions drawn by the management accountant are not executed automatically. He has to convince people at all levels. In other words, he must be an efficient salesman in selling his ideas.
- (iii) Management accounting is only a tool: Management accounting cannot replace the management. It is only an adviser to the management.

The decisions regarding implementing his advice are to be taken by the management. There is always a temptation to take an easy course of arriving at a decision by intuition rather than going by the advice of the management accountant.

- (iv) Wide scope: Management accounting has a very wide scope incorporating many disciplines. It considers both monetary as well as nonmonetary factors. This all brings inexactness and subjectivity in the conclusions obtained through it.
- (v) Top-heavy structure: The installation of management accounting system requires heavy costs on account of an elaborate organization and numerous rules and regulations. It can, therefore, be adopted only by big concerns.
- (vi) Opposition to change:

Management accounting demands a breakaway from traditional accounting practices. It calls for a rearrangement of the personnel and their activities which is generally not liked by the people involved.

Q2 Explain the significance of financial analysis

Significance of Financial Analysis

The financial statements provide a summarized view of the operations of a firm. As a matter of fact, one can know much about a firm by a careful examination of its financial statements. However, the focus of the financial analysis is on the key figures contained in the financial statements and the significant relationship that exists between them. Thus, financial analysis helps in evaluating the relationship between different items constituting the financial statements and obtaining a better understanding about the financial position and the performance of the firm. The significance of financial analysis can be summarized as follows:

- (i) Helps in screening: Financial analysis can serve as a preliminary screening tool in the selection of investments.

It greatly helps the investors in studying '3 Ps', i. e., Prospects, Payment and Protection. The prospects of a firm can be judged by looking to both, its present and the future profitability. The capacity of payment can be judged on the basis of present and prospective liquidity of the firm. The protection can be judged on the basis of tangible assets backing, which the firm enjoys.

- (ii) Helps in forecasting: Financial analysis can be used as a forecasting tool for future profitability and financial soundness of the business. A comparative study of the key figures in the financial statements facilitates this work.
- (iii) Helps in diagnosis: The financial analysis helps the

management in identifying the factors responsible for creating managerial, operating and other problems. (iv) Helps in evaluation: The financial analysis is an important tool for evaluating the performance of both the management and the organization. It is, thus, a yardstick used by the financial analyst to evaluate the financial condition and performance of the firm.

Q3 Discuss the limitations of accounting ratios.

Answer:-

Limitations of Accounting Ratios

Accounting ratios are subject to certain limitations. They are given below:

1. Comparative study required: Ratios are useful in judging the efficiency of the business only when they are compared with the past results of the business or with the results of a similar business. However, such a comparison only provides a glimpse of the past performance and forecasts for future may not prove correct since several other factors like market conditions, management policies, etc., may affect the future operations.
- Based only on financial statements: Ratios are based only on the information which has been recorded in the financial statements. As indicated in the preceding pages, financial statements suffer from a number of limitations; the ratios derived therefrom, therefore, are also subject to those limitations. For example, non-financial charges, though important for the business, are not revealed by the financial statements. If the management of the company changes, it may have ultimately adverse effects on the future profitability of the company but this cannot be judged by having a glance at the financial statements of the company.

Similarly, the management has a choice about the accounting policies.

Different accounting policies may be adopted by management of different companies regarding valuation of inventories, depreciation, research and development expenditure, and treatment of deferred revenue expenditure, etc. The comparison of one firm with another on the basis of ratio analysis without taking into account the fact of companies having different accounting policies, will be misleading and meaningless. Moreover, the management of the firm itself may change its accounting policies from one period to another. It is, therefore, absolutely necessary that financial statements are themselves subjected to close scrutiny before an analysis is attempted on the basis of accounting ratios. The financial analyst must carefully examine the financial statements and make necessary adjustments in the financial statements on the basis of disclosure made regarding the accounting policies before undertaking financial analysis.

The growing realization among accountants all over the world, that the accounting policies should be standardized, has resulted in establishment of International Accounting Standard Committee, which has issued a number of International Accounting Standards. In our country, the Institute of Chartered Accountants of India has established Accounting Standards Board of formulation of requisite accounting standards. The Accounting Standards Board has already issued twenty three accounting Standards including AS 1: Disclosure of Accounting Policies. The standard has become mandatory in respect of accounts for periods commencing on or after 1 April, 1991. 3. Ratios alone are not adequate: Ratios are only indicators; they cannot be taken as final regarding good or bad financial position of the business. Other

things have also to be seen. For example, a high current ratio does not necessarily mean that the concern has a good liquid position in case current assets mostly comprise of outdated stocks. It has been correctly observed, "No ratio may be regarded as good or bad per se'. It may be an indication that a firm is weak or strong but it must never be taken as proof of either one. Ratios may be linked to rail-roads. They tell the analyst, ' stop, look and listen'.

4. Window dressing: The term ' window dressing' means manipulation of accounts in a way so as to conceal vital facts and present the financial statements in away to show a better position than what it actually is. On account of such a situation, presence of particular ratio may not be a definite indicator of good or bad management. For example, a high stock turnover ratio is generally considered to be an indication of operational efficiency of the business. But this might have been achieved by unwarranted price reductions or failure to maintain proper stock of goods. Similarly, the current ratio may be improved just before the Balance Sheet date by postponing replenishment of inventory. For example, if a company has got current assets of ` 4, 000 while current liabilities of ` 2, 000, the current ratio is 2, which is quite satisfactory. In case the company purchases goods of ` 2, 000 on credit, the current assets would go up to ` 6, 000 and current liabilities to ` 4, 000, thus, reducing the current ratio to 1. 5.

The company may, therefore, postpone the purchases for the early next year so that its current ratio continues to remain at 2 on the Balance Sheet date. Similarly, in order to improve the current ratio, the company may pay off certain pressing current liabilities before the Balance Sheet date. For

example, if in the above case, the company pays current liabilities of ` 1, 000, the current liabilities would stand reduced to ` 1, 000, current assets would stand reduced to ` 3, 000 but the current ratio would go up to 3. 5.

Problem of price level changes: Financial analysis based on accounting ratios will give misleading results if the effects of changes in price level are not taken into account. For example, two companies set up in different years, having plant and machinery of different ages, cannot be compared, on the basis of traditional accounting statements.

This is because the depreciation charged on plant and machinery in case of old company would be at a much lower figure as compared to the company which has been set up recently. The financial statements of the companies should, therefore, be adjusted keeping in view the price level changes if a meaningful comparison is to be made through accounting ratios. The techniques of current purchasing power and current cost accounting are quite helpful in this respect.

6. No fixed standards: No fixed standards can be laid down for ideal ratios. For example, current ratio is generally considered to be ideal if current assets are twice the current liabilities. However, in case of those concerns which have adequate arrangements with their bankers for providing funds when they require, it may be perfectly ideal if current assets are equal to or slightly more than current liabilities.

It may, therefore, be concluded that ratio analysis, if done mechanically, is not only misleading but also dangerous. It is indeed a double-edged sword which requires a great deal of understanding and sensitivity of the management process rather than mechanical financial skill. According to Hunt, Williams and Donaldson in the book, Basic Business Finance (1971), It

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has rightly been observed, " The ratio analysis is an aid to management in taking correct decisions, but as a mechanical substitute for thinking and judgment, it is worse than useless. The ratios, if discriminately calculated and wisely interpreted, can be a useful tool of financial analysis." The computation of different accounting ratios and the analysis of the financial statements on their basis can be very well understood with the help of the illustrations given in the following pages

Q4 How does a funds flow statement differ from an income statement

Answer:

A funds flow statement differs from an income statement (i. e., profit and loss account) in several respects: (i) A funds flow statement deals with the financial resources required for running the business activities. It explains how the funds were obtained and how they were used. However, an income statement discloses the results of the business activities, i. e., how much has been earned and how it has been spent. (ii) A funds flow statement matches the 'funds raised' and 'funds applied' during a particular period. The sources and applications of funds may be of capital as well as of revenue nature.

An income statement matches the incomes of a period with the expenditure of that period which are both of a revenue nature. For example, where shares are issued for cash, it becomes a source of funds while preparing a funds flow statement but it is not an item of income for an income statement. (iii) Sources of funds are many, besides operations such as share capital, debentures, sale of fixed assets, etc. An income statement which discloses the results of operations cannot even accurately show the funds

from operations alone because of non-fund items (such as depreciation, writing off of fictitious assets, etc.) being included therein. Thus, both the income statement and the funds flow statement have different functions to perform. Modern management needs both. One cannot be a substitute for the other—rather they are complementary to each other

Q5Following are the extracts from the Balance Sheet of a company as on 31 December 2010 and 31 December 2011. You are required to calculate funds from operations Answer:-

FUNDS FROM OPERATIONS

Profit and Loss Appropriation A/c balance as on 31 December 2007 40, 000

Add: Items which do not decrease funds:

Transfer to General Reserve 5, 000

Goodwill written off 5, 000

Preliminary Expenses written off 2, 000

Provision for Depreciation on Machinery 2, 000

54, 000

Less: Profit and Loss Appropriation A/c balance as on 31 December 2006 30, 000 Funds from Operations 24, 000

Q6You are required to prepare a Comparative Balance Sheet on the basis of the Information given in the above Balance Sheets. Answer

COMPARATIVE BALANCE SHEET

Particulars 2007 2008Absolute Percentage

Change Change

`Liabilities

Share Capital 10, 00, 000 15, 00, 000 5, 00, 000 50%

Reserves 10, 00, 000 10, 00, 000 — —

Loan 2, 00, 000 8, 00, 000 6, 00, 000 300%

Current Liabilities 3, 00, 000 5, 00, 000 2, 00, 000 66. 67%

25, 00, 000 38, 00, 000 13, 00, 000 52%

Assets

Fixed Assets 20, 00, 000 30, 00, 000 10, 00, 000 50%

Current Assets 5, 00, 000 6, 00, 000 3, 00, 000 60%

25, 00, 000 38, 00, 000 13, 00, 000 52%

Roll no. 521117331

Name Chander Shekher

ASSIGNMENTS

M. Com – 3rd Semester

Subject Name: Management Accounting

Subject code: MCC 304

Set 2

Q1 Distinguish between cash flow analysis and funds flow analysis

Answer:-

Difference between Cash Flow Analysis and Funds Flow Analysis Following are the points of difference between a cash flow analysis and a funds flow analysis: 1. A cash flow analysis is concerned only with the change in cash position while a fund flow analysis is concerned with change in working capital position, between two balance sheet dates. Cash is only one of the constituents of the working capital besides several other constituents such

as inventories, accounts receivable, prepaid expenses. 2. A cash flow statement is merely a record of cash receipts and disbursements. Of course, it is valuable in its own way but it fails to bring to light many important changes involving the disposition of resources. While studying the short-term solvency of a business, one is interested not only in cash balance but also in the assets which can be easily converted into cash. 3. Cash flow analysis is more useful to the management as a tool of financial analysis in short-periods as compared to the funds flow analysis. It has rightly been said that the shorter the period covered by the analysis, the greater is the importance of cash flow analysis.

For example, if it is to be found out whether the business can meet its obligations maturing after ten years from now, a good estimate can be made about the firm's capacity to meet its long-term obligations if changes in working capital position on the account of operations are observed. However, if the firm's capacity to meet a liability maturing after one month is to be seen, the realistic approach would be to consider the projected change in the cash position rather than an expected change in the working capital position.

4. Cash is a part of working capital and, therefore, an improvement in cash position results in the improvement in the funds position but the reverse is not true. In other words, 'inflow of cash' results in 'inflow of funds' but inflow of funds may not necessarily result in 'inflow of cash'.

Thus, a sound funds position does not necessarily mean a sound cash position but a sound cash position generally means a sound funds position.

5. Another distinction between a cash flow analysis and a funds flow analysis can be made on the basis of the techniques of their preparation. An increase

in a current liability or decrease in a current asset results in decrease in working capital and vice versa. While an increase in a current liability or decrease in a current asset (other than cash) will result in increase in cash and vice versa. Some people use the term ' funds' in a very narrow sense of ' cash' only. In such an event, the two terms ' Funds' and ' Cash' will have synonymous meanings

Q2What are the steps involved in rational decision making

Answer

Rational decision-making requires taking the following steps:

1. Defining the problem: The problem must be clearly and precisely defined so that quantitative amounts that are relevant to its solution can be determined.
2. Identifying alternatives: The possible alternative solutions to the problem should be identified. Sometimes consideration of more alternative solutions may make matters more complex. In order to do away with this difficulty, after having identified all alternatives, the analysis should eliminate on a judgement basis those that are clearly unattractive. A detailed analysis of the remaining alternatives should then be done.
3. Evaluating quantitative factor: Each alternative is usually associated with a number of advantages (relevant revenues) and disadvantages (relevant costs). The decision maker should evaluate each of the relevant factors in quantitative terms to determine the largest net advantage.
- Evaluating qualitative factors: In most cases the advantages and disadvantages associated with each alternative are capable of being easily expressed in quantitative terms.

However, in certain cases there may be quantitative factors associated with certain alternatives which may not be capable of being expressed easily and correctly in quantitative terms. Evaluating such qualitative factors against the quantitative factors depends on the judgement of the decision maker. Sometimes on account of a single qualitative factor, which though cannot be measured exactly and easily in monetary terms, the decision may just be reverse of what it was generally expected to be. For example, it is a known fact that many persons can meet their transportation needs less expensively by using public conveyances rather than by operating their own automobiles. In spite of this, people own and use their own automobiles for reasons of prestige, convenience, or other factors which cannot be measured in quantitative terms.

5. Obtaining additional information: In case the decision maker feels necessary, he may ask for additional information. As a matter of fact, many decisions could be improved by obtaining additional information and it is usually possible to obtain such information. 6. Selection of an alternative: After having identifying, evaluating, weighing and obtaining additional information (if necessary), the decision maker can select the alternative and act on it. 7. Appraisal of the results: Having implemented his decision, the decision maker should also carry out an appraisal of the results from time to time. This will help him in correcting his mistakes, revising his targets and making better predictions in the times to come.

Q3 What are the advantages of the value added statement?

Answer

Advantages of Value Added Statement

Value Added Statement provides the following advantages:

1. Broader concept: Value added statement is based on 'enterprise theory' rather than 'entity theory'. In case of entity theory, net profit is computed on the basis that it is the reward of the proprietor (or shareholders, in case of a company). This is a traditional and narrow view of the term Net Profit or Net Income. On the other hand, in case of enterprise, the net value added represents the total income of the enterprise as a whole. The term 'enterprise' includes the employees, government, financiers or other persons who have a stake in the enterprise. Thus, 'value added' concept defines income in a broader sense, i. e., income for the society as whole and not for a particular individual or individuals.
2. Positive attitude of employees: Value added statement develops a positive and favourable attitude of the employees towards their company. This is because such statement reflects a broader view of the company's objectives and responsibilities.
3. Introduction of productivity-linked bonus scheme: Value added statement helps the organization in introducing productivity-linked bonus scheme. The employees can be paid bonus on the basis of Value Added/ Payroll ratio.
4. Useful diagnostic tool: Value added based ratios, e. g., value added/ payroll, taxation/value added, value added/sales, etc., are useful diagnostic and predictive tools. The organisation may compare its different value added ratios with those of other organisations to ascertain its performance, profitability vis-à-vis others and take such remedial measures as may be necessary.

It may be more useful if inflation adjusted value added ratios are used for comparison purposes.

5. Reliable ranking: Value added can serve as a better measure for ranking the companies according to their size and importance as compared to ranking them on the basis of sales or capital employed. This is because sales may be inflated or capital-intensive company with a few employees may appear to be more important than a company requiring intensive skilled labour.

6. Linking with national income; Value added statement links the company's financial statement with the national income. The value added statement discloses the company's contribution to national income.

Q4List the steps that may be taken to increase the speed of collection of accounting information

In order to have effective and efficient reporting, the following steps should be taken:

1. ' Reporting' should be the logical outcome of accounting routine. This requires detailed planning of flow of paper work and its analysis.
2. Efforts should be made to avoid duplication of work. Journals, ledgers, etc., should be designed in a way that ' control data' is available without additional analysis.
3. Codification and mechanization should be extensively used. They greatly help in quick preparation of reports.
4. Accounts for a period should be closed a few days before the close of the period. For example, accounts relating to the month of June may be closed on the 15th of June. The period from 15th June to 30th June may be used for processing the data and the reports may be sent on 1st July.
5. In case actual data is not readily available, the interim estimates may be used in their place. The quality of reports in such a case would depend upon the quality of estimates.

The actual figures may later be compared with the estimates and deviations or variations. These deviations or variations will help the responsible persons report better estimates for the future.

Q5Determine the selling price per unit to yield 20% return on capital employed. Answer

Let selling price per unit be x .

Total sales = 4, 00, 000 x

Capital employed = 9, 00, 000 + 2, 00, 000

Profit = 1, 80, 000 + 40, 000 x

Cost = 15 × 4, 00, 000 + 10, 20, 000

= 60, 00, 000 + 10, 20, 000

= `70, 20, 000

Sales = Cost + Profit

4, 00, 000 x = 70, 20, 000 + 1, 80, 000 + 40, 000 x

or 3, 60, 000 x = 72, 00, 000

or x = `20.

Q6From the following details compute the value of human resources of an employee group with an average age of 58 years

Alternatively the value of an employee can be computed with the help of Annuity Table. The present value of an annuity of ` 1 for two years at 10% is 1. 736. Hence, the present value of ` 20, 000 for two years comes to $20, 000 \times 1. 736 = ` 34, 720$. This is almost the same as calculated above. Since the total number of employees in the group are 10, hence the total value of human resources of this group comes to $34, 710 \times 10 = ` 3, 47, 100$. a