

Paper 8- Cost Accounting & Financial Management

Paper 8- Cost Accounting & Financial Management

Full Marks:100

Time allowed: 3 hours

Section A : Answer Question No. 1 which is compulsory Carries 25 Marks

1. Answer the following questions

(A) Each Question carries 2 Marks

[5 × 2 = 10]

(i) Material Cost

Particulars	Amount (₹)
Invoice Value	10,000
(+) Transport	200
Material Cost	10,200

Damages paid ₹ 350/- cannot be considered for computing material cost.

(ii) Cost for Job No. 111

Particulars	Amount (₹)
Direct Material	760
Direct Labour	550
Prime Cost	1,310
Overheads (60% on 550)	330
Factory Cost	1,640
(+) Profit (25% 1640)	410
Price of Job	2,050

(Profit is 20% on selling price means 25% on cost)

(iii) Depreciation per hour = $\frac{\text{Cost of Asset} - \text{Scrap Value}}{\text{Life of the asset}} = \frac{30,000 - 6,000}{10 \text{ years}} = ₹ 2,400 \text{ P. A.}$

Depreciation per hour = $\frac{\text{Depreciation P. A.}}{\text{Annual Weekly Hour}} = \frac{2,400}{24,000} = 0.10$

i.e., 10 paise or ₹ 0.10.

(iv) Present value of 2,00,000 at the end of 3 years @ 10%

DCF @ 10% Rate for 3 years = 0.751

P.V. of 2,00,000 = 2,00,000 × 0.751 = ₹ 1,50,200.

(v) Average collection period = 2 months

Average Receivables = ₹ 6,50,000

Particulars	Amount (₹)
Credit Sales P.A. = $6,50,000 \times \frac{12}{2}$	39,00,000
Cash Sales	5,00,000
Total Sales	44,00,000

MTP_ Intermediate_ Syllabus 2012_ June2016_ Set 2

(B) State whether the following statements are True or False

5 × 1 = 5

- (i) True
- (ii) True
- (iii) True
- (iv) False
- (v) False

(c) Fill in the Blanks

5 × 1 = 5

- (i) Costing Profit & Loss A/c
- (ii) Costing department
- (iii) Opportunity cost / Notional Cost / Imputed Cost
- (iv) Current Liabilities
- (v) Internal Rate of Return

(D) Match the Following

5 × 1 = 5

(i)	(B)
(ii)	(E)
(iii)	(A)
(iv)	(C)
(V)	(D)

Sec-B

Answer any three Question from Q. No 2,3,4 and 5. Each Question carries 15 Marks

2. (A) $EOQ = \sqrt{\frac{2 \times A \times O}{C}} = \sqrt{\frac{2 \times 35,000 \times 25}{1 \times 20\%}} = \sqrt{\frac{18,00,000}{0.2}} = 800 \text{ units.}$

Statement Showing computation of comparative inventory cost of existing policy and proposed EOQ policy:

	Particulars	Existing Policy		EOQ	
(i)	Purchase Cost	(36000 × 1)	36,000	(36000 × 1)	36,000
(ii)	Ordering Cost	[36000 / 6000 × 25]	150	[36000 / 3000 × 25]	300
(iii)	Carrying Cost	[1/2 × 6000 × 1 × 20%]	600	[1/2 × 3000 × 1 × 20%]	300
			36,750		36,600

Saving by using EOQ = 36,750 – 36,600 = ₹ 150.

(B) Perpetual Inventory System may be defined as 'a system of records maintained by the controlling department, which reflects the physical movements of stocks and their current balance'. Thus it is a system of ascertaining balance after every receipt and issue of materials through stock records to facilitate regular checking and to avoid closing down the firm for stock taking.

Advantages of perpetual inventory system:

- (a) The system obviates the need for the physical checking of all items of stock and stores at the end of the year.
- (b) It avoids the dislocation of the routine activities of the organization including production and dispatch.
- (c) A reliable and detailed check on the stores is maintained.
- (d) Errors, irregularities and loss of stock through other methods are quickly detected and through necessary action recurrence of such things in future is minimized.

- (e) As the work is carried out systematically and without undue haste the figures are readily available.
- (f) Actual stock can be compared with the authorized maximum and minimum levels, thus keeping the stocks within the prescribed limits. The disadvantages of excess stocks are avoided and capitalized up in stores materials cannot exceed the budget.
- (g) The recorder level of various items f stores are readily available thus facilitating the work of procurement of stores.
- (h) For monthly or quarterly financial statements lime Profit and Loss Account and Balance Sheet the stock figures are readily available and it is not necessary to have physical verification of the balances.

3. (A) Computation of factory cost under three systems:

Particulars	Time Rate System	Halsey Plan	Rowan Plan
Material	4.00	4.00	4.00
Labour (Working notes)	2.25	1.88	2.00
Overheads	3.38	2.82	3.00
Factory Cost	9.63	8.70	9.00

Working Notes:

Particulars	Time Rate System	Halsey Plan	Rowan Plan
Labour	9×0.25	$6 \times 0.25 + \frac{1}{2} (9-6) \times 0.25$	$6 \times 0.25 + (9-6 / 9) \times 6 \times 0.25$
	2.25	1.88	2.00

(B) General principles in designing the system of remuneration to Employee

Remuneration is the reward for labour under normal circumstances and is generally based on either time spent or on the result produced. The former is called "time-related" remuneration and the latter is known as "Piece-related" remuneration. The fixation of method of remuneration in a proper manner is vitally important for any organization because it deals with the most sensitive item of the input, i.e., Labour.

The general principles which should be considered in designing a proper method of labour remuneration is summarized below:

- (a) The basis should be simple to understand and the various segments of the system, should clearly mention in detail.
- (b) The employees should be able to accept the method without any doubts or hesitation in their mind.
- (c) The method should be flexible enough to adopt any changes or variation which may become inevitable at a later stage.
- (d) The method should be able to cut down/stabilize the labour turnover which is often causes due to unsatisfactory or unacceptable method of remuneration.
- (e) The method should assure fair wages to the employees so that both the employers and the employees can gain by such methods, the former by way of higher earnings.
- (f) Incentive payments, should be a part of the method of remuneration with a view to increase the labour productivity.
- (g) The method should be able to minimize the level of absentees so that avoidable wastages in labour cost can be reduced.
- (h) The method should ultimately result into higher production and improved quality of the output.

4. (A) Statement showing apportionment of overheads and computation of OH rates:

MTP_ Intermediate_ Syllabus 2012_ June2016_ Set 2

Particulars	Basis	Total (₹)	A	B	C	X	Y
Power	KWH (4:3:2:1:1)	1,100	400	300	200	100	100
Wages	Actual	45,000	---	---	---	15,000	30,000
Material	Actual	45,000	---	---	---	22,500	22,500
Lighting	Light Point (5:8:2:3:2)	200	50	80	20	30	20
Stores overhead	Materials (2:4:4:3:3)	800	100	200	200	150	150
Welfare of staff	No. of workers (2:3:3:1:1)	3,000	600	900	900	300	300
Depreciation	Assets Value (6:4:3:1:1)	30,000	12,000	8,000	6,000	2,000	2,000
General Overheads	Direct Wages (2:3:4:1:2)	12,000	2,000	3,000	4,000	1,000	2,000
Rent & Taxes	Area (3:5:1:1:1)	550	150	250	50	50	50
		1,43,650	17,700	14,330	12,570	41,530	57,520
Costs of 'X'	5:3:2		20,765	12,459	8,306	(41,530)	---
Costs of 'Y'	2:3:4		12,782	19,173	25,565	---	(57,520)
			51,247	45,962	46,441	---	---

Overhead Rate as % on direct wages

$$A = [51,247 \div 30,000] \times 100 = 170.82\%$$

$$B = [45,962 \div 45,000] \times 100 = 102.14\%$$

$$C = [46,441 \div 60,000] \times 100 = 77.40\%$$

(B) Under or over absorption of overheads may arise due to one or the other causes given below:

- (a) Error in estimating overhead expenses
- (b) Error in estimating the level of production
- (c) Major unanticipated changes in the methods of production
- (d) Unforeseen changes in the production capacity
- (e) Seasonal fluctuations in the overhead expenses from period to period
- (f) Overhead rate may be applied to Normal capacity which different from the operating capacity of the firm.

5. (A) Quotation for a Printing Job

Items	Amount (₹)	Amount (₹)
Direct material required:		
Paper 10 × 1800	18,000	
Ink & other printing material	5,000	
Binding material & consumables	3,000	
Primary packing material	4,000	30,000
Direct labour spent		
Artist (12,000/25 × 6) × 80	6,400	
Copy writer (10,000 / (25 × 6)) × 75	5,000	
Client Servicing (9,000 / (25 × 6)) × 30	1,800	13,200
Photographer's charges		10,000
Prime Cost		53,200
Factory Overheads applied @ 40% on Direct Cost		21,280
Production Cost		74,480
S&D overheads applied @ 25% on Production Cost		18,620
Total Cost		93,100
Profit (20% on price i.e., 25% on cost)		23,275
Price to be quoted		1,16,375

(B) Advantages of Cost Accounting

Cost Accounting has manifold advantages, a summary of which is given below. It is not suggested that having installed a system of Cost Accounting, a concern will expect to derive all the benefits stated here. The nature and the extent of the advantages obtained will depend upon the type, adequacy and efficiency of the cost system installed and the extent to which the various levels of management are prepared to accept and act upon the advice rendered by the cost system.

The Cost Accounting System has the following advantages:

- (i) A cost system reveals unprofitable activities, losses or inefficiencies occurring in any form such as
 - (a) Wastage of man power, idle time and lost time.
 - (b) Wastage of material in the form of spoilage, excessive scrap etc., and
 - (c) Wastage of resources, e.g. inadequate utilization of plant, machinery and other facilities.
- (ii) Cost Accounting locates the exact causes for decrease or increase in the profit or loss of the business. It identifies the unprofitable products or product lines so that these may be eliminated or alternative measures may be taken.
- (iii) Cost Accounts furnish suitable data and information to the management to serve as guides in making decisions involving financial considerations.
- (iv) Cost Accounting is useful for price fixation purposes. Although sale price is generally related more to economic conditions prevailing in the market than to cost, the latter serves as a guide to test the adequacy of selling prices.
- (v) With the application of Standard Costing and Budgetary Control methods, the optimum level of efficiency is set.
- (vi) Cost comparison helps in cost control. Comparison may be period to period, of the figures in respect of the same unit or factory or of several units in an industry by employing Uniform Costs and Inter-Firm Comparison methods. Comparison may be made in respect of cost of jobs, process or cost centres.
- (vii) A cost system provides ready figures for use by the Government, wage tribunals and boards, and labour and trade unions.
- (viii) When a concern is not working to full capacity due to various reasons such as shortage of demands or bottlenecks in production, the cost of idle capacity can readily worked out and repealed to the management.
- (ix) Introduction of a cost reduction programme combined with operations research and value analysis techniques leads to economy.
- (x) Marginal Costing is employed for suggesting courses of action to be taken. It is a useful tool for the management for making decisions.
- (xi) Determination of cost centres or responsibility centres to meet the needs of a Cost Accounting system, ensures that the organizational structure of the concern has been properly laid responsibility can be properly defined and fixed on individuals.
- (xii) Perpetual inventory system which includes a procedure for continuous stock taking is an essential feature of a cost system.
- (xiii) The operation of a system of cost audit in the organization prevents manipulation and fraud and assists in furnishing correct and reliable cost data to the management as well as to outside parties like shareholders, the consumers and the Government.

Sec- C

Answer any two Questions from Q. No 6, 7 and 8. Each Question carries 15 Marks

6 (A) G.P. given = 4,00,000/-

G.P. Ratio : 25%

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

$$\begin{aligned} \text{(i) Sales} &= \text{Gross Profit} \times \frac{100}{\text{Gross Profit Ratio}} \\ &= 4,00,000 \times \frac{100}{25} = 16,00,000 \end{aligned}$$

Debtors Velocity 3 months

$$\begin{aligned} \text{Average Debtors} &= \text{Sales} \times \text{Debtors Velocity} \\ &= 16,00,000 \times \frac{3}{12} = 4,00,000 \end{aligned}$$

Bills Receivable given : ₹ 25,000.

$$\begin{aligned} \text{(ii) Sundry Debtors} &= \text{Total Debtors} - \text{Bills Receivable} \\ &= 4,00,000 - 25,000 = 3,75,000 \end{aligned}$$

$$\begin{aligned} \text{(iii) Sales} &= 16,00,000 & \text{G.P.} &= 4,00,000 \\ \text{Cost of Goods Sold} &= \text{Sales} - \text{G.P.} = 16,00,000 - 4,00,000 = 12,00,000 \end{aligned}$$

Let 'x' be the opening stock, then the closing stock will be x + 10,000,

$$\text{Average Stock} = \frac{\text{Opening Stock} + \text{Closing Stock}}{2} = \frac{x + x + 10,000}{2}$$

Average Stock = x + 5000

Stock Velocity = 8 months

$$\text{Stock velocity} = \frac{12 \text{ months in year}}{\text{Inventory Turnover}}$$

$$= \text{Inventory Turnover ratio} = \frac{12 \text{ m}}{8 \text{ m}} = 1.5 \text{ times}$$

$$\text{Inventory Turnover Ratio} = \frac{\text{Cost of Goods Sold}}{\text{Average Stock}}$$

$$1.5 = \frac{12,00,000}{x + 5000}$$

$$1.5x + 7500 = 12,00,000$$

$$X = 7,95,000$$

Opening Stock = 7,95,000, Closing Stock is 10,000 above the opening stock.

$$\text{So, Closing Stock} = 7,95,000 + 10,000 = 8,05,000$$

We know that Cost of Goods Sold = Opening Stock + Purchases – Closing Stock

$$\Rightarrow 12,00,000 = 7,95,000 + \text{Purchases} - 8,05,000$$

$$\begin{aligned} \Rightarrow \text{Purchases} &= 12,00,000 + 10,000 \\ &= 12,10,000 \end{aligned}$$

Creditors Velocity 2 months

$$\text{Creditors} = 12,10,000 \times \frac{2}{12} = 2,01,667$$

Bills Payable 10,000

$$\text{Sundry Creditors} = 2,01,667 - 10,000 = 1,91,667.$$

(B) Determinants of Working Capital

The size or magnitude and amount of working capital will not be uniform for all organisations. It differs from one type of organisation to the other type of organisation. Depending upon various conditions and environmental factors of each and every organisation. There are many factors that determine the size of working capital. However, there are some factors, which are common to the most of the business concerns. Such factors are enumerated below:

1. **Nature and size of the Business:** A company's working capital requirements depends on the activities it carried on and its size too. For instance, public utility organisation or service organisation where its activities are of mere service nature, does not require high amount of working capital, as it has no need of maintaining any stocks of inventories. In case of trading organisation the magnitude of working capital is high as it requires to maintain certain stocks of goods as also some credit to debtors. Further, if we go to manufacturing organisation the cycle period of working capital is high because the funds are to be invested in each and every type of inventory forms of raw-material, work-in-progress, finished goods as also debtors. Industrial units too require a large amount of working capital.
2. **Production Policies:** These policies will have a great significance in determining the size of the working capital. Where production policies are designed in such a way that uniform production is carried on throughout the accounting period, such concern requires a uniform and lesser amount of working capital. On the other hand, the concerns with production policies according to the needs of the customers will be peak at sometimes and require high amount of working capital. In seasonal industries too, where production policies are laid down tightly in the business season requires a high amount of working capital.
3. **Process of Manufacture:** If the manufacturing process of a particular industry is longer due to its complex nature, more working capital is required to finance that process, because, longer the period of manufacture, the larger the inventory tied up in the process and naturally requires a high amount of working capital.
4. **Growth and Expansion of Business:** A business concern at status requires a uniform amount of working capital as against the concerns which are growing and expanding. It is the tendency of any business organisation to grow further and further till its saturation point, if any. Such growth may be within the existing units by increased activities. Similarly, business concerns will expand their organisation by establishing new units. In both the cases, the need for working capital requirement increases as the organisation increases.
5. **Fluctuations in the Trade Cycle:** Business activities vary according to the general fluctuations in the world. There are four stages in a trade cycle which affects the activities of any business concern. Accordingly, the requirements of working capital are bound to change. When conditions of boom prevail, it is the policy of any prudent management to build or pile up large stock of inventories of various forms to take the advantage of the lower prices. Such fluctuations causes a business concern to demand for more amount of working capital. The other phase of trade cycle i.e., depression i.e., low or absence of business activities cause business concerns to demand for more working capital. In condition of depression, the products produced are not sold due to fall in demand, lack of purchasing power of the people. As a result of which entire production obtained was not sold in the market and high inventories are piled up. Therefore, there arises the need for heavy amount of working capital.
Thus, the two extreme stages of trade cycles make the business concerns to demand for more working capital. In the former case due to acts and policies of management and in the later case due to natural phenomena of trade cycle.
6. **Terms and conditions of Purchases and Sales:** A business concern which allows more credit to its customers and buys its supplies for cash requires more amount of

working capital. On the other hand, business concerns which do not allow more credit period to its customers and seek better credit facilities for their supplies naturally require lesser amount of working capital.

7. **Dividend Policy:** A consistent dividend policy may affect the size of working capital. When some amount of working capital is financed out of the internal generation of funds such affect will be there. The relationship between dividend policy and working, capital is well established and very few companies declare dividend without giving due consideration to its effects on cash and their needs for cash.

If the dividend is to be declared in cash, such outflow reduces working capital and therefore, most of the business concerns declare dividend now-a-days in the form of bonus shares as such retain their cash. A shortage of working capital acts as powerful reason for reducing or skipping cash dividend.

8. **Price Level Changes:** The changes in prices make the functions of a finance manager difficult. The anticipations of future price level changes are necessary to avoid their affects on working capital of the firm. Generally, rising price level will require a company to demand for more amount of working capital, because the same level of current assets requires higher amount of working capital due to increased prices.

9. **Operating Efficiency:** The Operating efficiency of a firm relates to its optimum utilisation of resources available whether in any form of factor of production, say, capital, labour, material, machines etc; If a company is able to effectively operate its costs, its operating cycle is accelerated and requires relatively lessor amount of working capital. On the other hand, if a firm is not able to utilise its resources properly will have slow operating cycle and naturally requires higher amount of working capital.

10. **Percentage of Profits and Appropriation out of Profits:** The capacity of all the firms will not be same in generating their profits. It is natural that some firms enjoy a dominant and monopoly positions due to the quality of its products, reputations, goodwill etc. (for example Colgate Tooth Paste, Bata Chapels etc..) and some companies will not have such position due to poor quality and other inherent hazards.

The company policy of retaining or distribution of profits will also affect the working capital. More appropriation out of profits than distribution of profit necessarily reduces the requirements of working capital.

11. **Other Factors:** Apart from the above general considerations, there may be some factors responsible for determination of working capital which are inherent to the type of business. Some of such factors may be as follows:

- (a) General co-ordination and control of the activities in the organisation.
- (b) Absence of specialisation of products and their advantages.
- (c) Market facilities.
- (d) Means of transport and communication system.
- (e) Sector in which the firm works i.e., private or public sector etc.
- (f) Government policy as regard to:
 - (i) Imports and Exports
 - (ii) Tax considerations.
- (g) Availability of labour and its organisation.
- (h) Area in which it is situated such as backward, rural sub-urban, etc.,

7. (A) Calculation of Operating Leverage:

	Situation A (₹)	Situation B (₹)	Situation C (₹)
Number of unit sold	800	800	800
Sales @ ₹ 15	12,000	12,000	12,000

MTP_Intermediate_Syllabus 2012_June2016_Set 2

Variable cost @ ₹ 10	8,000	8,000	8,000
Contribution	4,000	4,000	4,000
Fixed cost	1,000	2,000	3,000
EBIT	3,000	2,000	1,000
Operating Leverage	1.33	2.00	4.00
Contribution/EBIT			

Calculation of Financial Leverage:

	Plan I	Plan II	Plan III
Situation A			
EBIT	₹ 3,000	₹ 3,000	₹ 3,000
Less: Interest @ 12%	600	300	900
Profit before Tax	2,400	2,700	2,100
Financial Leverage (EBIT/Profit before Tax)	1.25	1.11	1.43
Situation B			
EBIT	₹ 2,000	₹ 2,000	₹ 2,000
Less : Interest @ 12%	600	300	900
Profit before Tax	1,400	1,700	1,100
Financial Leverage (EBIT/Profit before Tax)	1.43	1.18	1.82
Situation C			
EBIT	₹ 1,000	₹ 1,000	₹ 1,000
Less: Interest @ 12%	600	300	900
Profit before Tax	400	700	100
Financial Leverage (EBIT/Profit before Tax)	2.5	1.43	10.0

Calculation of Combined Leverage:

The combined leverage may be calculated by multiplying the operating leverage and financial leverage for different combination of Situation A, B & C and the Financial Plans, I, II & III as follows:

	Situation A	Situation B	Situation C
Plan I	1.66	2.86	10
Plan II	1.47	2.36	5.72
Plan III	1.90	3.64	40

The calculation of combined leverage shows the extent of the total risk and is helpful to understand the variability of EPS as a consequence of change in sales levels. In this case, the highest combined leverages is there when financial plan III is implemented in situation C; and lowest value of combined leverage is attained when financial plan II is implemented in situation A.

(B) Calculation of value of firm and overall cost of capital under Net Income approach

Value of firm = MV of Equity + MV of Debt

EBIT	50,000
Less: Interest (2,00,000 × 10%)	20,000
Equity Earnings	30,000
Equity Capitalisation Rate (K_e)	12.5%

MTP_Intermediate_Syllabus 2012_June2016_Set 2

Therefore,

	₹
Value of Equity = $\frac{30,000}{12.5\%}$	2,40,000
Value of Debt (Given)	2,00,000
Value of Firm	4,40,000

Overall Cost of Capital (K_o)

$$K_o = 12.5 \times \left[\frac{2,40,000}{4,40,000} \right] + 10 \times \left[\frac{2,00,000}{4,40,000} \right]$$

$$K_o = 11.36\%$$

8. (A) Initial Cash outflow = 20 lakhs

DCF = 10%

Life of the project = 5 years

$$\text{Depreciation} = \frac{\text{Cost} - \text{Salvage Value}}{\text{Life}} = \frac{20 \text{ Lakhs} - 0}{5} = 4 \text{ lakhs Per Annum.}$$

Working Note:

Cash Flow and their present value

Year	Cash Flow before Depreciation & Tax	Depreciation	PBT	Tax @ 50%	PAT	Cash Inflow (PAT + Dep)	DCF	P.V.
1	4	4	0	0	0	4	0.909	3.636
2	6	4	2	1	1	5	0.826	4.13
3	8	4	4	2	2	6	0.751	4.506
4	8	4	4	2	2	6	0.683	4.098
5	10	4	6	3	3	7	0.621	1.347
						P.V. Cash Inflow		20.717

Total Profit = 8 lakhs

$$\text{Average Net Income} : \frac{8 \text{ lakhs}}{5} = 1.6 \text{ lakhs}$$

Payback Period: Time required to recover the Investment of ₹ 20 lakhs

$$\text{Payback Period} = 3 \text{ years} + \frac{5}{6} \text{ years} = 3.833 \text{ years} = 3 \text{ years } 10 \text{ months.}$$

$$\text{ARR} : \frac{\text{Average Net Income}}{\text{Original Investment}} \times 100 = \frac{1,60,000}{20,00,000} \times 100 = 8\%$$

$$\text{NPV} : \text{P.V. of Cash Inflows} - \text{P.V. of Cash outflow} \\ = 20.717 \text{ lakhs} - 20 \text{ lakhs} = 0.717 \text{ lakhs.}$$

$$\text{Benefit Cost Ratio} = \frac{\text{P.V. of Cash Inflows}}{\text{P.V. of Cash Outflow}} = \frac{20.717}{20} = 1.036.$$

(B) Need of Preparing Cash Flow Statement

Cash Flow Statement shows the changes in cash position between two Balance Sheet dates. It provides the details in respect of cash generated through operating, investing and financial activities and utilised for operating, investing and financial activities. The transactions which increase the cash position of the business are known as Inflows of cash (ex: Sale of current and fixed assets, Issue of shares and debentures etc.) The transactions which decrease the cash position are known as outflows (ex: Purchase of Current and Fixed Assets, redemption of Debentures, and Preference Shares and other long term debts). Cash Flow Statement concentrates on transactions that have a direct impact on cash. This statement depicts factors responsible for such inflow and outflow of cash.

- (i) Cash Flow Statement reveals the causes of changes in cash balances between two Balance Sheet dates.
- (ii) This statement helps the management to evaluate its ability to meet its obligations i.e., payment to creditors, the payment of bank loan, payment of interest, taxes, dividend etc.
- (iii) It throws light on causes for poor liquidity in spite of good profits and excessive liquidity in spite of heavy losses.
- (iv) It helps the management in understanding the past behaviour of cash cycle and in controlling the use of cash in future.
- (v) Cash Flow Statements helps the management in planning repayment of loans, replacement of assets etc.
- (vi) This statement is helpful in short-term financial decisions relating to liquidity.
- (vii) This statement helps the management in preparing the cash budgets properly.
- (viii) This statement helps the financial institution who lends advances to business concerns in estimating their repaying capacities.
- (ix) Since a Cash Flow Statement is based on the cash basis of accounting it is very useful in evaluation of cash position of a firm.
- (x) Cash Flow Statement discloses the complete story of cash movement. The increase in, or decrease of cash and the reason therefore can be known.
- (xi) Cash Flow Statement provides information of all activities such as operating, investing, and financing activities separately.
- (xii) Since Cash Flow Statement provides information regarding the sources and utilisation of cash during a particular period, it is easy for the management to plan carefully for the cash requirements in the future, for the purpose of redeeming long-term liabilities or/and replacing some fixed assets.
- (xiii) A projected Cash Flow Statement reveals the future cash position of a concern. Through this Cash Flow Statement the firm can know how much cash it can generate and how much cash will be needed to make various payments.
- (xiv) Cash Flow Statement prepared according the AS-3 (Revised) is more suitable for making comparison than the funds flow statements as there is no standard formats used for the same.