CHAPTER 3

THEORETICAL ASPECTS OF THE STUDY

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3.1 NATURE OF THE PROBLEM :

Most of the Companies are in business, only with a view to earn profit. In the current atmosphere of inflation, where costs are continuously rising, it is not so easy to retain the profit. But profit is a must, atleast for the survival of the Company.

Before industrial revolution one or two members of a family used to run a small business - one product, one location, small markets etc. This is the age of diversified, multi-products, & multi-location organisations. Advancing technology, rising costs, fluctuating economies and computerisation make today's business climate more competitive.

Thus in business or industry, inflation & competition on one side and survival and profit on other side, necessitate a proper system of information and reporting to Management.

3.1.1 INFORMATION :

The dictionary meaning of the term information is knowldge.

But in a wider term, "Information is the behaviour - intiating stimuli between sender and receiver. Information is in the form of signs that are coded representations of data"[1].

Information affects the behaviour of men or machines. The data to be called as information must be properly arranged and reacted upon;otherwise it is not called as an information. Thus the

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1. ROBERT G. MURDICK & JOEL E ROSS : Information Systems for Modern Management : Prentice Hall of India Pvt. Ltd. New Delhi : 1982 P No.438.

properly arranged data or signs that affect the behaviour either immediately or after passage of time constitute information.

a. CHARACTERISTICS :

Some of important characteristics of information may be given as follows -

1. Purpose :

The basic purposes of information are to inform, evaluate, persuade or to organise other things or information.

Therefore, there must be some purpose at the time of transmission of information either to a person or to a machine. If there is no purpose then it is nothing but simplly the data or noise.

2. Mode & Formate :

The modes as well as formates of information may differ for human beings & for machines. The modes of information for human are sensary such as througth sight, hearing, taste touch and smell etc. On the other hand machines are capable of receiving information In the mode of electrical, chemical etc.

Human beings receive most of their information in the form of oral or writtern documents. Whereas, machines receive information in the form of energy, tapes, cards. etc.

3. Frequency :

The value of the information depends upon the frequency with which it is transmitted or received, e.g. Finanacial reports prepared weekly may show a little change, so that they have small value. Whereas, monthly reports may indicate big changes to show some problems or trends.

4. Reliability :

Reliability may be expressed as the degree of confidence the decisioin maker places in the information.

5. Validity :

The validity of information is a measure of the degree to which the information represents, e.g.Fixation of consumption norms on some assumptions which are different from the factors affecting the norms reduce the validity of the norms.

b. TYPES OF INFORMATION :

The types of information depends upon the nature of information which in turn depends upon the level of management using the information.

The nature of top management's responsibilities revolves around strategic planning. Information for planning purposes stresses the future which is inexact and difficult to programme. Thus, the nature of information for the top management is unstructured, non-programmed future and inexact.

On the other hand, the nature of information for the operating management is structured, programmed and exact.

Middle management always comes in between top and operating management having elements of both.

c. MEDIA OF INFORMATION :

The information is generally operated or transformed through the following media -

1. Oral :

Face-to-face, telephone, signals, loudspeakers, calling bells etc.

2. Written :

Reports, statements, charts, graphs, conveyor systems etc.

In order to decide the means of information transmission to be used, the following points should be considered.

Speed :

How soon after despatch must the information reach the person for whom it is intended ?

Accuracy :

Will the information be received accurately ? If figures are spoken over the telephone they are liable to be misheard.

Safty :

What is the risk of losing the information in transit ?

Secrecy :

What is the possibility of leakage of information ? Does it matter if persons other than the recipient become aware of the information ?

Records :

Is it necessary that the information should be in writing for the purpose of record?

Impression :

The information should be in such a form as to produce the desired effect on the person receiving it, e.g. urgent information should be given by telex instead of letters etc

Cost :

The cost of transmission of the information should not be more than the importance of the matter.

3.1.2 SYSTEM :

a. Definition :

1. "A system is a set of elements forming an activity or a processing procedure/scheme seeking a common goal or goals by operating on data and/or energy and/or matter in a time reference to yield information and/or energy and/or matter"[2].

2. Webster defines system as,"a set or arrangement of things so related or connected to form a unity or organisation"[3].

The two definitions make it clear that the system is an activity of set of elements during a certain period towards a common goal or goals. It is a regular and orderly way of doing something.

Thus, in a system all elements work together effectively than if they were operating independently.

A system concerned with the form or how something is is being accomplished. The information system is based on the physical facilities that are available. The information system should concentrate on improving the management control over the existing facilities a nd materials.

b. Types of information system -

An information system may be an integrated system or a functional system.

1. Integrated system -

An integrated system implies that all the functional systems are linked together in to one Entity. Integration means

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2. ROBERT G MURDICK & JOEL E ROSS : information systems for modern management : Prentice Hall of India Pvt.Ltd. New Delhi, 1982 P.No. 9

3. JEROME KANTER management Information systems : Prentice Hall of India Pvt. Ltd. : 1984-P.13.

taking a complete picture look at the inter-locking functional systems that operate within a company.

2. Functional system :

Functional systems may be designed to meet the needs of a restricted area of the company's operation but with the needs of the whole organisation in mind.

The following examples of functional systems give the idea about the nature and scope of functional system of information.

a. Marketing :

Marketing function includes - Sales planning, market research, order processing, forecasting, sales analysis, advertising etc.

b. Finance :

Finance function includes - capital budgeting, profit planning, accounts receivables, accounts payables, billing, pay--roll, cost accounting etc.

Any system aims at planning and controlling of that system in a proper way so as to help the management for its smooth functioning.

3.1.3 REPORT :

a. Definition :

Lancesters has defined a Report as -

"A Report is a statement /collected and considered /of facts, so drawn up as to give clear and concise information to persons who are not already in possession of the full facts of the subject matter of the Report"[4].

4. B. N. TONDON : A Handbook of Practical Auditing : S. Chand & Co., New Delhi, 1969, P. No. 245.

A Report is one of the controlling devices, in the form of a written communication addressed to a specific management personnel for taking specific action. Good reporting provides an invaluable tool of control for different levels of managemnt. For the purpose of control it is essential that various levels of management are supplied with the required information which may guide them in taking necessary action.

Reporting to management is performed through the best possible means of reports, statements, charts and graphs so as to enable the management to take appropriate actions. A good report, for the management, is a mirror of -

a. Favourable and unfavourable past act ions.

b. Present situation, and

c. Future trends.

Therefore, with the help of the reports, the management is able to evaluate the results of the plan, to take necessary actions for the achievement of the goals, and to plan for the future.

The nature of reports and the reporting system differ from industry to industry, company to company and it is different for different levels of management even in the same company. Therefore, the reporting system should be designed according to the requirements of that particular management to whom the reports are to be submitted. And also the information to be submitted needs frequent review and adjustments to the changing requirements of the management.

b. Classification of Reports :

Reports can be classified by their form, contents and frequency as shown in the following table.

TABLE 3.1

TYPES OF REPORTS

- FORM
  - Descriptive
  - Tabular
  - Graphical
- CONTENTS
  - Production
  - Sales
  - Finance etc.
- FREQUENCY
  - Routine
  - Special

Source : P. Dasgupta : Studies in Cost Accounting.

A good report must show its class under frequency, form and contents, e.g. :-

1. A special graphical production report.
2. A routine tabular sales report.

The special reports may be asked by the management to deal with the special problems. The special reports are proposed in dealing with the problems currently developed. These reports may cover wide field of activities, such as -

1. Taxation legislation,
2. Technical developments in the industry,
3. Information about competitive products etc.

On the other hand, routine reports are submitted to the management at regular intervals to help them to control the affairs effectively and efficiently. Following are some of the important reports which are of routine nature.

1. Various budgets.
2. Monthly or quarterly profit and loss account, and balance sheet.

3. Major statistics of orders received, sales and production etc.

4. Cost reports.

5. Reports on recovery and payments.

6. Sales with prices and selling expenses etc.

c. Important qualities of a good Report :

A good report which gives a bird's eye view possesses some of the general guiding principles which are as follows :-

1. Good form and content :

The report should be in a suitable form. It should have suggestive title, sub-headings and paragraph divisions. The recipient of the report should be indicated on the top of the report.

Information should be submitted in an important manner. It should not be affected by personal opinions. The comtents of the report should follow a logical sequence, such as -

1. Summary of present position.

2. Courses of action which might be taken, with the expected results.

3. Recommendations and the reasons for their submission.

2. Promptness :-

The report should be put up as quickly as possible. Because if there is considerable time lag between the occurence and reporting, opportunity for an action may be lost or some wrong decisions may be taken in the absence of information.

The periodicity of reporting in case of routine reports will depend on factors like -

1. Nature of the report.

2. Uses of the report as compared with time.

3. Effective action that can be taken on the basis of the reports.

3. Accuracy :-

The report must be correct within the margin of error allowed, otherwise the management may lose faith in the reports. What is an allowed margin of error will depend upon the purpose for which the report is prepared. Attempts at accuracy should not result in giving unnecessary details or in delaying reporting.

4. Comparison :-

Whereever possible, reports of actual performance should show a comparison either with the past performance or with the pre-determined targets. This facilitates a correct assessment of the current performance. Continuous comparison of the actuals with the budgeted results is the great secret about the validity and correctness of the reports.

As an alternative to complete compari..son, the reports may highlight significant deviations from standards. Such reports take the minimum time of the recipient and also enable their attention to be focused on significant exceptions. This is called "Reporting by exceptions".

5. Simplicity :-

Simplicity means the presentation of report in a clear manner. It should be easy to understand. The use of graphic devices will greatly enhance the utility of the reports.

6. Cost consideration :-

The cost of maintaining a system of reporting should not be more than the benefits derived therefrom. But it is very difficult to assess the value of reports in terms of money. Therefore, it should be left to the judgement of the accountant to render the information in the most economical way.

7. Length of reports :-

Every report should be brief as far as possible. But this should not be at the cost of clarity and accuracy. It is also important to note that a brief report submitted in time will yield better result than a detailed but delayed report.

8. Graphic representation :-

Graphs and charts enable to present information in a simple and effective manner. This justifies the graphic presentattion of reports. Graphs and charts present information in a pictorial manner and easily attract the attention of recipient towards the contents of the reports. Graphs and charts are the most effective media for disclosing trends and comparisons. charts are usually used to explain narrative reports consisting of figures.

The various methods of graphic presentation are as follows

A) BAR CHARTS :

A bar chart makes use of horizontal or vertical columns to represent magnitudes of value, quantity or period. The longer the column, higher the magnitude. Bar charts are of different types.

a. SIMPLE BAR CHARTS :

These charts indicate direct comparison of the items like production, sales, product cost etc.

b. MULTIPLE BAR CHARTS :

These charts represent two or more sets of inter--related data on one chart.

c. SUB-DIVIDED BAR CHARTS :

These are used in indicating the analysis of cost or sales by their constituent elements.

d. PERCENTAGE BAR CHARTS :

Here the dicision of components is shown on the basis of percentage. The whole bar represents 100%.

B) PIE OR CIRCULAR CHARTS :-

Pie charts are percentage charts. These are represented as segments of a circle.

C) Z CHARTS :-

They comprise three curves on a single graph and take the shape of letter Z. These three curves usually represent the following :-

1. Current figures for the period concerned.
2. Cumulative figures up to the date, and
3. Moving annual total.

D) BREAK-EVEN CHARTS :-

These charts show the inter-relationship between variable and fixed costs and sales value. They also show the estimated profit or loss at different levels of activity.

They indicate the break even point. It is the point at which total cost is equal to total revenue.

E GANTT CHARTS :-

This chart shows the bars (horizontally) of planned schedules and accomplished performances.

3.1.4 MANAGEMENT :-

a) DEFININTION :-

There are many definitions of management which emphasize one or the other important aspect of management activity. Some of the definitions are as follows :-

1. Daltan E. McFarland :-

" Management is the fundamental integrating and operating mechanism underlying organised effort "[5].

2. Harald Koontz and Cyril O'Donnel :-

" Creation and maintenance on an internal environment in an enterpirse where individuals, working together in groups can perform efficiently and effectively toward the attainment of group goals "[6].

3. George R. Terry :-

" Management is a distinct process....performed to determine and accomplish stated objectives by the use of human beings and other resources "[7].

All the above definitions indicate the common contention that management involves both the determination and the accomplishment of organisational goals. But management involves more than

5. B.P.SINGH & T. N. CHHABRA : Essentials of Management : Kitab Mahal,15,Thornhill Road,Allahabad 1979 P No. 5
6. __________Ibid__________
7. __________Ibid__________

this, it also evaluates the effectiveness of goal accomoplishment and and devises methods for achieving those tasks. The following definition includes these aspects.

4. W. Jack Duncan :-

> "Management consists of all organisational activities that ienvolve goal formation and accomplishment, performance appraisal, and the development of an operating philosophy that ensures the organisation's survival within the social system". [8]

Thus, management has become one of the most important factors of production together with land, labour and capital. The factors of production, without management, have no value. Unless they are managed,the factors will remain as factors only. Therefore in order to convert the factors into production, management is necessary. Thus, we can say that the management is the process of planning and controlling the affairs.

b) CHARACTERISTICS OF MANAGEMENT :-

The following are some of the important characxterstics which clearly indicate the nature of management.

1. Management is an integrative process :-

The essence of management is the integration of human and other resources in such a manner that it leads to effective performance. All the resources are made available to those who manage, and they apply knowledge, experience, principles for getting the results.

2. Management makes things happen :-

Managers focus their attention and efforts in bringing

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8. B.P.SINGH & T.N.CHHABRA : Essentilals of Management : Kitab Mahal, 15, Thornhill Road, Allahabad 1979 P. No. 5

about successful action. Successful managers have the motive force for accomplishment. They know where to start and how to follow for accomplishment of a particular thing.

3. Management is accomplished by, with, and through the efforts of others :-

Some scientists have defined the term management as the art of getting things done through people.Thus, management is an art, ability and skill of a person in getting work done through people at work.

4. Management is purposeful :-

Management deals with the achievement of some specific objective. Managerial success is measured by the extent to which the obejctives are achieved. Thus, management exists where work exists..

5. Management is intangible :-

Management has been called as an unseen force. It is result oriented. Its presence is evidenced by the result of its efforts. The effectiveness or ineffectiveness of management is judged only on the basis of the results. It can not be seen or touched but it can be judeged or experienced.

c) LEVELS OF MANAGEMENT :-

The term levels of management refers to a line of limits between various managerial positions in an orgainsation. To communicate the policies of the management, steps are required for easy passage towards the workers. In order to pass the technique of the management towards subordinates, levels are constructed from top to bottom (workers)

The number of levels of management increases when the size of the business and work force increases. But it can not be increased to an unlimited extent because it may create many problems of communication, co-operation and control. On the other hand it should be windend to restrict the number of managerial levels. Though some of the companies have an organisational hierarchy consting of four, five or more levels, there are mainly three levels of management. They are as follows :-

1. Top Management :-

It consists of the Board of Directors, Managing Director or General Manager.

2. Middle Management :-

It consists of departmental or executives or managers responsible for important functions such as purchase, stores, production, sales, finance, accounts etc.

3. Lower level or operating management :-

It consists of supervisors, foremen or next to departmental heads etc.

d) INTERACTION OF THE LEVELS OF MANAGEMENT :-

Top management establishes the policies, plans and objectives of the company. It also establishes the general budget frame work under which the various departments will operate.These factors are passed down to middle management.

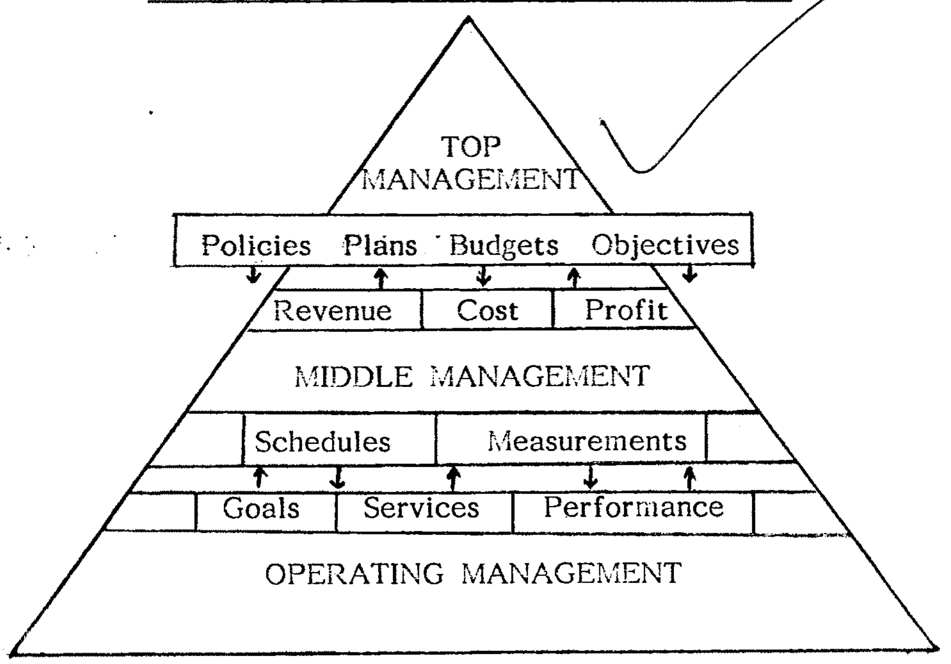
The policies, plans, objectives and the other factors passed from top management are translated by the middle management into specific revenue, cost and profit goals, particularly if each department works under a cost or profit centre concept. These are reviewed, analysed and modified in accordance with the overall plans and policies until agreement is reached. Then the middle management issues the specific schedules and measurement yardsticks to the lower level or operating management.

Lastly, the result of operating management's activity is the end product itself. It has the job of producing goods and services required to meet the revenue and profit goals. This will enable the company to reach its overall plans and objectives.

Table 3.2 gives clear idea at a glance about the interaction of the levels of management.

TABLE 3.2

INTERACTION OF MANAGEMENT LEVELS



Source : JEROME KANTER : Management Information Systems : P.5

3.1.5 REPORTING AND LEVELS OF MANAGEMENT :-

It has been already seen that the nature of reporting is different for different levels of management even in the same company. Therefore, it is necessary to study the nature of reports required by different levels of management.

1. REPORTING AND TOP LEVEL MANAGEMENT :-

Top level management makes long range policies and takes decisions relating to the objectives of the business. Therefore, the reporting for this level should posses the following characteristics :-

a. It should focus on the efficiency and inefficiency of the departmental operations.

b. The information supplied should be profit motivated.

c. Only those facts which deviate from the standards fixed should be reported.

d. An analysis for the deviations should be given.

e. It should cover commercial and financial aspects bringing out all the activities which have a financial bearing.

f. Though it should cover all the activities, instead of details, only the summarised important points should be given.

g. Reporting for this level should follow the principle of "reporting by exception".

2. REPORTING AND MIDDLE MANAGEMENT :-

This is the level which is responsible for the implementation of the plans and policies set by the top management. This level is required to take short term decisions. This level has to control only its particular function and it is not necessary to peep into the function of others.

Therefore, the reporting for this level should show the results of operating level. These reports should be slightly broad-based than those of lower level. These reports should show the efficiency for the concerned group or department.

3. REPORTING AND OPERATING MANAGEMENT :-

This is the level which is directly responsible for the day to day operations of the various sectors of the business. This level has nothing to do with the formation of plans and policies of the business.

The reports for this level should be detailed and specific, restricted to the activity with which the foremen or supervisors are concerned. These reports should state the variations of actual performance from the plans. These variations should be both in physical and monetary terms.

3.2 SCOPE OF THE PROBLEM :-

It is already mentioned in the scope and limitations of the study that the study is limited to the information system and reporting to management in respect of financial control of working capital.

> " To manage efficiently the working capital of an enterprise, two types of control i.e. financial and physical are applied. Financial control is related with maintaining sufficient flow of finance for the operation of business, whereas, physical control is used particularly in respect of inventory control "[9].

Thus the study covers the information system and reporting to management only in respect of financial control. It is implied that control is preceded with planning. Therefore, the scope of the problem can be stated in the following manner :-

9. Company News & Reports : Calcutta : Vol. IX No.5 : May 1984 P. A/285.

1. It covers the information system and reporting to management in respect of planning and control of financial aspect of working capital.

2. It covers the study of important documents used in the process of planning and control of working capital.

3. It is purely internal.

4. It is implied that the information system is upward or downward within the levels of management whereas reporting is always upward or at the most to the equal level.

3.2.1 WORKING CAPITAL :-

a. MEANING :-

The term working capital is generally related to the amount of funds required for smooth functioning of day to day business affairs.

Shubin defines -

> " Working capital is the amount of funds necessary to cover the cost of operating the enterprise. Working capital in a going concern is a revolving fund, it consists of cash receipts from sales, which are used to cover the cost of current operations "[10].

It may also be defined in two ways or there are two concepts regarding working capital such as 'Gross concepts' and ' net concepts'.

1. Gross concept:-

" The sum of current assets is the working capital of a business."[11]. - J. S.Mill.

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10. Prof. DESAI & Prof. LIMAYE : A Guide to Business Finance : M.V.Phadke & Co.Kolhapur : 1982.
11. Dr. WARMA & AGARWAL : A Guide Financial Management : Foward Book Depot : Delhi, 1986 : P. No. 151.

Thus gross working capital refers to the total of current assets. Current assets are those assets which can be changed into cash within a short period not exceeding a year. The components of current assets are as follows :-

i. Cash in hand and at bank.

ii. Stock of raw materials, finished goods and work-in-process.

iii. Bills receivables.

iv. Debtors for goods sold.

v. Pre-paid expenses, etc.

2. Net Concept :-

Working capaital = Current assets - current liabilities.

Net working capital refers to the exess of current assets over current liabilities and provisions. Current liabilities are those which are intended to be paid within a short period (normally a year).The components of current liabilities are as follows :-

i. Creditors for goods received.

ii. Bills payable.

iii. Bank overdraft.

iv. Accrued expenses.

v. Taxation etc.

b. TYPES OF WORKING CAPITAL :-

Table 3.3 shows the types of working capital. These different types are explained in short as follows :-

1. Permanent/Fixed Working Capital :

It is the working capital which is required to maintain minimum stock of raw materials, stock of finished goods and work-in-process.

2. Regular Working Capital :

The minimum amount of liquid capital needed to keep up the circulation of capital from cash to inventory to receivables and again to cash, is known as regular working capital.

3. Reserve margin :

It is the excess working capital over the regular needs. It is kept in reserve for contingencies such as rising prices, depreciation, strikes etc.

4. Seasonal Working Capital :

It is the working capital which is required to meet the seasonal needs.

5. Special Working Capital :

It is the working capital which is required for financing special operations such as experiments with new products etc.

TABLE 3.3

TYPES OF WORKING CAPITAL

- Permanent/Fixed
  - Regular
  - Reserve Margin OR Cushion
- Variable
  - Seasonal
  - Special

Source : Dr.VARMA & AGARWAL : A Guide to Financial Management : P. No. 152.

3.2.2 PLANNING OF WORKING CAPITAL :-

Planning is concerned with deciding in advance the future action to be taken. It is concerned with taking action at present to prevent becoming absolute in the future.

Planning of working capital provides no other lesson than ' Forecast operations ', then time and money will be spent in a proper way. Forecasting operations summerises what management is all about. Though it is difficult to forecast accurately, it does not mean that it is impossible to forecase accurately.

It is not possible to draw proper conclusion from any information unless there are some measures of comparison with which we can compare actual results. And most of the measures of comparison are depending upon Profit and Loss Account and Balance Sheet which are the mirrors of business operations. Therefore, the successful planning of working capital includes the following :

1. Preparation of Budgeted Profit & Loss Account :-

This shows the reqwuired quantum of sales, production, purchases, and other expenses for a particular period of time. It is nothing but determination of business operations, the amount of required working capital and also the source of working capital in the form of Profit.

2. Preparation of Budgeted Balance Sheet :-

Balance Sheet is a statement of assets and liabilities of concern on a particular date.

The liability side of the balance sheet indicates the sources of funds, such as -

Liabilities -

Capital,

Reserves & Surplus,

Loans - Secured & unsecured,

Current liabilities and provisions.

On the other hand the asset side of the balance sheet shows the application of the funds, such as -

Assets -

Fixed Assets,

Investments

Current Assets,

Fictitious Assets.

Thus the budgeted profit and loss account shows the required funds for business operations throughout the period; and the balance sheet shows the components of gross as well as net working capital on a particular date.

3. Preparation of Cash Budget :-

Cash does not grow on trees, but companies do not have much difficulty in getting it one way or another. It would be obtained through extended credit from the suppliers, increased over-draft facilities from banks or accelerating debt colletion.

But during the present inflationary period hiking raw material prices and increasing costs more finance is required. And at the same time inflation factor also affects profit margin which reduces cash in flow from operations. In such a difficult situation the secret of good cash management is the cash budget. "A cash budget is a detailed estimate for some future period of time of cash inflows from all sources, cash disbursements for all purposes and the resultant cash balances "[12].

Advantages of Cash Budget :-

1. Cash budget is useful to ascertain cash position to ensure prompt payments of debts on maturity.
2. It enables to determine the quantum, the timing of, and the period for which, the surplus funds can be invested in some other way.
3. It indicates the points of inadequacy of cash resources, which are useful for arrangement of inflow of the same.

Thus it is a planning tool for arranging new borrowings or for suitable investment of surplus funds.

Table 3.4 gives clear idea about the Cash Budget.

A planned cash flow enables to avoid financial difficulties. A good cash management enables to operate the following four major functions :-

a. Determination of minimum cash balances.
b. Effective borrowing.
c. Advantageous investment of excess cash.
d. Acceleration of cash flow.

Cash balances should be maintained at the lowest level, because excess cash earns nothing and losses purchasing power in a period of rising prices. Effective planning for investment of excess cash will maximise its earnings.

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12. MAN MOHAN & S.N.GOYAL : Principles of Management Accounting : Sahitya Bhavan, Agra, 1980 : P. No. 57.

TABLE 3.4

CASH BUDGET

Particulars/Month :-	July	Aug	Sept........	Total
Opening balance				
Receipts:-				
Cash sales				
Receipts from debtors				
Other receipts				
Total Rs. :-				
Payments :-				
Purchases				
Wages				
Factory overheads				
Administration overheads				
Selling overheads				
Selling commission				
Research expenditure				
Capital purchases				
Dividend				
Tax				
Total Rs. :-				
Cash balance (+ or -)				
Estimated overdrafts				
Balance				

Source : MAN MOHAN & S. N. GOYAL : Principles of Manangement Accounting : P. No. 60

4. Assessment of Working Capital requirements:-

Excess working capital leads to blocking the scares funds while inadequate working capital interrupts production and hampers profitability. Therefore, correct assessment of working capital is very important.

As shown in table 3.5, it is possible to assess the requirement of working capital correctly. It can be assessed either for a week, for a month or as per the requirement.

TABLE 3.5

ASSESSMENT OF WORKING CAPITAL REQUIREMENTS

Particulars	Estimated Amount
1. Current Account-	
i) Raw materials (including stores and other items used in the process of manufacture)	
a) Imported (months's consumption)	
b) Inddigenous (month's consumption)	
ii) Other consumable spares (% of total inventory and month's consumption)	
iii) Stock-in-process (months's cost of production)	
iv) Finished goods (Month's cost of sales)	
v) Receivables other than export and deferred receivables (including bills purchased and discounted by bankers) (Months' domestic sales excluding deferred payment sales)	

vi) Export receivable including bills purchased and (discounted by bankers)
(Months' exports sales)

vii) Advances to supplies of raw materials and stores/spares consumable

viii) Other current assets including cash and bank balances and deferred receivables due within one year.

TOTAL CURRENT ASETS

2. Current Liabilities-
(Other than bank borrowing for working capital)

i) Creditors for purchases of raw materials and stores and consumable spares
(Months' purchases)

ii) Advances from customers

iii) Accrued expenses

iv) Statutory liabilities

v) Other current liabilities

Sub-total

3. Working capital gap (I minus 2)

4. Acutal/projected bank borrowings for working capital including bills purchased and discounted and excess borrowing placed on repayment basis

5. TOTAL CURRENT LIABILITIES (2 plus 4)

6. NET WORKING CAPITAL (1 minus 5)

Source :- Credit authorisation form (CAS) of THE UNITED WESTERN BANK LTD.,

3.2.3 CONTROL OF WORKING CAPITAL :

" Managerial function of control implies measurement of actual performance, camparing it with the standards set by plans and correction of deviations to assure attainment of objectives according to plans "[13].

" All management control techniques have five common and essential principles "[14].

1. Setting up an aim to be achieved.
2. Communicating the aim to those concerned with achieving it.
3. Monitoring what actually happens.
4. Comparing actual achievement with the aim,and identifying causes of variances.
5. Taking action either to rectify errors or to change the aim.

Thus, controlling is seeing that actual performance is guided towards expected performance. Control involves proper implimentation of the plans and policies laid down by the top management.

Control of working capital involves the application of control techniques to the working capital with a view to keep on track the smooth functioning of the business operations. The control techniques of working capital may be mentioned as follows :-

1. Budgetory control.
2. Cost control.
3. Ratio analysis.
4. Funds flow statement.
5. Internal audit.

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13. B.P.SINGH & T.N.CHHABRA : Essentials of Management : Kitab Mahal, 15, Thornhill Road, Allahabad 1979, P.No.207.
14. Company News & Reports : Calcutta : Vol.IX No.4 April 1984 P. No. A/204.

1. Budgetory Control -

Budgetory control is a system which uses budgets as a means of planning and control. Budgetory control reveals the following main stages :-

a) Establishment of budgets, in order to anticipate the problems long before they arise and to find out the solutions through careful study.

b) Continuous comparison of the actual performance with that of the budget so as to determine the variations from the budget

c) Ascertainment of the reasons for such variations of actual from the budgeted performance and taking suitable remedial action to achieve the objective or to provide a basis for its revision.

In order to make possible the easy comparison of actuals with the budgeted performance, 'vertical' type is preferred to 'T' type of profit and loss account, and balance sheet.

2. Cost Control -

Cost control offers a gold mine of profit opportunities. It offers an opportunity to save money and service in the business. To control expenditure and to provide a basis for policy, marginal cost is in fact superior to other systems of costing.

An important element in marginal costing is disclosing between variable, fixed and semi-fixed expenses. These expenses may be explained as follows :-

Variable cost :-

Variable cost is the cost which is fixed per unit but varies in total. It means it increases/decreases as per the increase or decrease in production e.g. raw materials, power, fuel etc.

Fixed cost :-

Fixed cost is the cost which is fixed in total but varies per unit. It increases per unit if production decreases and it decreases if the production increases. e.g. depreciation, insurance, rates & taxes etc.

Semi-fixed :-

These are the costs which are fixed upto certain limit,thereafter they require increase e.g.machinery repairs may be constant upto say 75% of the capacity, if the working capacity increases it will require additional repairs.

Statement of profit may be prepared as follows :-

Particulars	Amount Per unit	Amount Total
Selling price		
Less : variable cost		
Contribution		
Less : fixed cost		
Profit :-		

Marginal costing, with its concept of contribution per unit towards fixed cost and profit, emphasises the most significant factor - the true effect of changes of volume of production - and is a more reliable basis for policy decision.

The main purposes of marginal costing are :-

1. To control expenditure.
2. To set an economic selling price.
3. To provide a basis for policy.

3. Ratio Analysis :-

One of the best methods of obtaining knowledge of financial statements is in the consideration of accounting ratio. The underlying theory of ratios is that there is a relationship between certain items in the Profit and Loss Account, and the Balance Sheet; and this establishes a pattern of behaviour.

An intelligent use of ratio is useful because -

a. It establishes a pattern.

b. It reveals changes in the pattern.

c. It enables the pattern to be compared with those of of other companies.

d. It links the change in the pattern to change in profitability

e. It indicates whether executive action could change the pattern.

Working capital can be controlled through a system of ratios as follows :-

A) Liquidity ratios :-

a) Current ratio $= \dfrac{\text{Current assets}}{\text{Current Liabilities}} = X : Y$ ratio

Comments :-

i) It is used to know the liability of a business to meet its maturing current obligations.

ii) If the ratio persistantlyfalls to, and even goes below, one, it may indicate impending insolvency.

iii) Satisfactory ratio is 2:1.

b) Acid Test Ratio $= \dfrac{\text{Liquid Assets}}{\text{Liquid Liabilities}} = X : Y$ Ratio

Comments :-

i) It is used to derive a picture of the capacity of a firm to meet its short term obligations out of short term resourses.

ii) Satisfactory ratio is 1:1.

iii) Liquid assets mean current assests less inventories and liquid liabilities mean current liabilities less bank overdraft

B) Operating Efficiency Ratios :-

a) Stock Turnover Ratio = $\frac{\text{Net Sales}}{\text{Average inventory at cost/at selling price}}$ = No of times.

Average inventary = $\frac{\text{Opening stock + Closing stock}}{2}$

Comments :-

i) It is used to avoid any danger of overstocking.

ii) It indicates the velocity with which merchandise moves through the business.

iii) There is no fixed norm for this ratio. It depends upon the the nature of industry and sales policies of the firm.

b) Debtors Turnover Ratio = $\frac{\text{Trade debtors}}{\text{Net sales/day}}$ = No of days

Net sales/day = $\frac{\text{Net sales}}{\text{No of working days.}}$

Comments :-

i) It is used to know how many days' average sales are tied up in debtors.

ii) The dues beyond credit period means lack of effective policies or inability of the collection department,.

c) Turnover of inventories (individual items) :-

i) Raw materials $= \dfrac{\text{Raw materials}}{\text{Average daliy sales}} =$ No of days

ii) Work-in-progress $= \dfrac{\text{Works-in-progress}}{\text{Average daily sales}} =$ No of days.

iii) Finished goods $= \dfrac{\text{Finished goods}}{\text{Average daily sales}} =$ No of days.

Comments :-

The above three ratios indicate, whether the funds are wisely used.

C) Financial Management Ratios :-

a) Turnover of working capital $= \dfrac{\text{Net sales}}{\text{Average net working capital}} =$ No.of times

Comments :-

It indicates whether there is under/over trading or just enough working capital.

b) Use of funds $= \dfrac{\text{Inventaries}}{\text{Gross working capital}} \times 100 = \%$

Comments :-

It shows, what portion of gross working capital is tied up in inventary.

c) Bank borrowing $= \dfrac{\text{Bank borrowings}}{\text{Gross working capital}} \times 100 = \%$

Comments :-

i) It is used to know , how much bank borrowing is used for working capital.

c) Availing credit $= \frac{\text{Creditors' Balance}}{\text{Average daily purchases}} =$ No of days.

Comments :-

It is used to know how much average credit period is enjoyed.

4. Funds Flow Statement :-

This statement is prepared primarily with a vew to disclose the real effects of the year's operations on the financial liquidity of the business. Funds flow statement shows how the activities of the business have been financed or how the financial resources have been used during a particular period.

The statement points out the effectiveness with which management has handled the working capital during the period. It generally reports changes in current assets and current liabilities. It is undoubtedly true that the funds flow statement supplies information which is not otherwise available in the conventional statement.

> " Properly handled, a statement of funds is better suited for the dissemination of this type of information than the conventional statement with its highly abstract, sophisticated cost allocations, and estimates and its completely different orientation"[15].

For constructing the statement, it is necessary to find out the increase/decrease in the various assets and liabilities from the Balance Sheets at the beginning and at the end of the period for which it is being prepared. And with the help of Profit & Loss A/c, the statement can be constructed as shown in table 3.6.

15. MAN MOHAN & S. N. GOYAL : Principles of Management Accounting : Sahitya Bhavan, Agra 1980 P. No. 479.

TABLE 3.6

FUNDS FLOW STATEMENT

Particulars		Estimated Amount
SOURCES		
	Profit before tax	
	Add : depreciation	
	Gross funds generated	
	Less : taxes paid/payable (relating to the year)	
	Less : dividents paid/payable (relating to the year)	
A)	Sub-total-Net funds generated	
	Increase in capital	
	Increase in Term Loans/Debentures/ Deferred payment liabilities	
	Increase in Public deposits	
	Decrease in fixed assets	
	Decrease in inter-corporate investments and advances	
	Decrease in other non-current asserts	
B)	Sub-total	
	Increase in short-term bank borrowings (including bill purchased and discounted by bankers)	
	Increase in other current liabilities	
	Decrease in inventory	
	Decrease in receivables (including bill purchased and discounted by bankers)	
	Descrease in other current assets (including cash & bank balances)	
C)	Sub-total	
	TOTAL FUNDS AVAILABLE (A+B+C)	

Particulars	Estimated Amount
USES	
Increase in fixed assets	
Decreas in Term loan/Debentures/ Deferred payment liabilities	
Decrease in public deposits	
Increase in inter-corporate investments and advances	
Increase in other non-current assets	
D) Sub-total	
Decrease in short term bank borrowings (including bills purchased and discounted by bankers)	
Decrease in other current liabilities	
Increase in inventory	
Increase in receivables (including bills purchased and discounted by bankers)	
Increase in other current assets (including cash and bank balances)	
E) Sub-total	
Loss	
Less : depreciation	
Balance i.e. Gross funds lost (-) or Gross funds generated (+)	
Add : taxes paid/payable (relating to the year)	
Add: dividends paid/payable (relating to the year)	
F) Sub-total	
TOTAL FUNDS USED (D+E+F)	

Source : Credit authorisation form (CAS) of THE UNITED WESTERN BANK LTD.,

5. Internal Audit :-

The auditor is the person who is - responsible for an unbiased scrutiny of the accounts to determine whether or not the financial statements reflect a true and fair view of the activities and state of affairs of the enterprise.

Since the internal auditor is a part of the overall management system, his view point should be that of the manager. Therefore, internal audit is known as the "audit of the management, for the management, by the management "[16].

The role of the internal auditor is of an unbiased commentator. The internal audit function is valuable to the management as a support system which provides three separate services :-

a) Control Audit:-

Control Audit is primarily procedure-oriented and does not normally seek to question the policies. Its procedure is that the work of one person must be checked by another person, which is known as internal control system.

b) Management Audit :-

This refers to specific assignments entrusted to the internal auditor for the purpose of identifying irregularities, weaknesses or even the reasons for failure in any area of the enterprises.

c) Operations Audit :-

In this kind audit the entire area of operations or even a single operation is studied in depth to determine the efficiency of the operations(s).

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16. Chartered Secretary : Institute of Company Secretaries of India: New Delhi, March 1985 P.No. 159.

According to Koontz & Donnell -

" Operation auditing in its broadest sense is the regular and independent appraisal, by a staff of internal auditors, of the accounting, financial and other operations of the business. Although, often limited to the auditing of accounts, in its most useful aspect operational auditing involves appraisal of operations generally, weighing actual results in the light of planned results "[17].

Thus, the internal audit being a rich source of information has become one of the important tools of management control. The internal auditors should not be attached to the accounting and finance department but they should report directly to Chief Executive of the enterprise. This will make the internal auditing control more effective.

17. B.P.SINGH & T.N.CHHABRA : Essentials of Management : Kitab Mahal, 15, Thornhill Road, Allahabad 1979 P.No. 219.