Q) Any 5 Types of Accounting Concepts

1. **Business Separate Entity Concept**

Also known as the Entity Concept. The essence of this concept is to **consider a business as a separate entity different from the owner.** It is an economic unit with its own identity.

For the purpose of **bookkeeping**, we must keep the owners and their business separate. A business unit has its own assets and liabilities. This enables the accountants and the business to differentiate between transactions of a company and private transactions of the owners.

Key highlights

- Business and owners are different.
- A firm has its own assets and obligations.
- This makes it easy for accounting information users to segregate a transaction.

Example – Business Separate Entity Concept

Suppose there is a business started by Mr Unreal for 10,00,000 (1 Million) and he takes out 50,000 for his personal use. Now, if there was no separate entity concept, then the cash deduction would have ideally happened from the capital as an expenditure of the business.

Now, with the business entity concept in place, the cash deduction is termed as "*Drawings*" and shown as a 3rd party (the owner in this case) is drawing money out of the capital. The balance sheet after the deduction will be shown as:

Balance Sheet					
Liabilities			**Assets**		
Capital	10,00,000		Cash		9,50,000
Less Drawings	50,000	9,50,000			

		9,50,000			9,50,000

Related Topic – What are Accounting Principles?

2. Going Concern Concept

The basic assumption, in this case, is that a **business will operate for a long time and there is no reason why a business should be encouraged for a short period** only to dissolve it in the near future. The assumption is termed as the Going Concern Concept.

It is assumed that the business will not be dismissed in the near future. Financial statements are drawn with this assumption. The concept basically helps in the distinction between long-term or short-term expenses and liabilities. In case this concept is not followed, it should be clearly mentioned in the financial statements along with the appropriate reasons.

Key highlights

- A strong assumption that an enterprise is a going concern and will continue operations for the foreseeable future.
- Helps to determine short-term and long-term obligations of the business.
- A business needs to clearly provide reasons if it doesn't agree with this assumption.

Example – Going Concern Concept

Let us take the same example as previously used where Mr Unreal had invested 10,00,000 in his business. Mr Unreal purchased a vehicle for 2,00,000 before the end of the financial year. Now, if Mr Unreal decided not to follow the going concern assumption and sell off his business, the financial situation might be different due to loss or profit on the sale of the asset.

He might have less money on hand after selling off the vehicle. If the going concern is assumed, then the increase or decrease in the value of the asset in the short-term is ignored. Now, if Mr Unreal follows the going concern concept, the financial situation of the business at the beginning of the next financial period will be as follows:

Balance Sheet

Liabilities			**Assets**	
Capital	10,00,000		Vehicle	2,00,000
			Cash	8,00,000
		10,00,000		**10,00,000**

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3. Money Measurement Concept

All transactions of a business are recorded in terms of money. According to this concept, only transactions which can be recorded in terms of money are recorded.

In other words, an event or a transaction that can't be expressed in terms of money can't be recorded in the books of accounts. The reason for this is that money provides a uniform way to measure the value of goods and services.

<u>Key highlights</u>

- If it has to go in the accounting books, it has to be measurable in terms of money.
- The concept has its limitations and inadequacies.

Example – Money Measurement Concept

5 Trucks, 300 kg of raw material, 10 tables and 5 Chairs all make no sense to be mentioned in the books.

There are 2 major flaws with this concept:

1. It assumes stability in the value of money, i.e. it doesn't account for inflation.
2. Many factors of vital performance are outside the purview of accounting.

4. Periodicity Concept

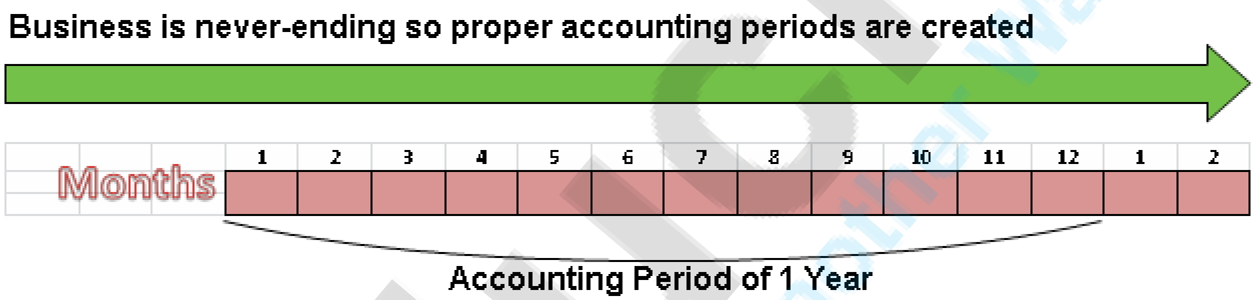
Also called the Concept of definite Accounting Period. According to this concept, the life of a business is broken into smaller periods called accounting periods so that the performance can be measured at fixed intervals. An accounting period could be a year, half-year or even a quarter.

It could be said that the business is here to stay for a long time, according to the going concern concept. So, the financial statements of the enterprise should be prepared at the end of its life.

It is possible, but not practical as the users of financial statements need the information at regular intervals, so that decisions can be taken in a timely fashion.

<u>Key highlights</u>

- Even though the life of a business is considered indefinite (according to the going concern concept) it still needs to be divided into equal intervals for accounting purposes.
- An accounting period is usually one year and is called the accounting year.



Example – Periodicity Concept

Let’s assume that if a financial company lasts for 150 years, it is impractical and undesirable to measure its performance and financial position at the end of 150 years. Therefore, the life of the company is divided into equal intervals to measure the financial position of the business. The periodicity concept results in the following benefits:

- Comparing financial positions at different intervals.
- Proper matching of periodic revenues and expenses to meet the objectives of accounting.
- Consistent accounting treatment to find out profit and valuation of assets.

5. Accrual Concept

According to this concept, a transaction is recorded in the books of accounts at the time of their occurrence and not when the actual cash or a cash equivalent is received or paid.

The profit earned or the loss incurred for a period is the result of both cash and credit transactions, hence it is possible that certain incomes are earned but not received and, similarly, certain expenses are incurred but not yet paid during an accounting period.

It is relevant to consider them while working out the financial results, only because they are related to the concerned accounting period.

Key highlights

- It doesn't matter when the cash is paid or received. A transaction is recorded at the time of its occurrence.
- Profit is said to be earned at the time the goods or services are sold to a customer, i.e. a legal title of the goods is passed to the customer.

Example – Accrual Concept

On December 31, 2013, the interest receivable on a fixed deposit was 1000 (assuming that the accounting year was to be closed on December 31, 2013). The interest amount was deposited in the bank on January 12, 2014.

According to the accrual concept, the income of 1000 from the interest on the fixed deposit belongs to the year 2013 and not 2014, even though the cash was actually received in 2014. The same applies to the expenses. Four important scenarios that emerge due to accrual concept are:

1. **Prepaid expense**
2. **Outstanding expense**
3. **Accrued Income**
4. **Income received in advance**

6. Cost-Attach Concept:

This concept is also known as "cost-merge" concept. When a finished good is produced from the raw material there are certain process and costs which are involved like labor cost, power and other overhead expenses. These costs have a capacity to “merge” or “attach”

when they are broughtr together.

7. Dual Aspect Concept:

As per this concept, every business transaction has a dual affect. For example, if Ram starts business with cash Rs. 1,00,000/- there are two aspects of the transaction: “Asset Account” and “Capital Account”. The business gets asset (cash) of Rs. 1,00,000/- and on the other hand the business owes Rs. 1,00,000/- to Ram.

Q) What is the difference between cash flow and funds flow statement?

	Basis of Difference	Funds Flow Statement	Cash Flow Statement
1.	**Basis of Analysis**	Funds flow statement is based on broader concept i.e. working capital.	Cash flow statement is based on narrow concept i.e. cash, which is only one of the elements of working capital.
2.	**Source**	Funds flow statement tells about the various sources from where the funds generated with various uses to which they are put.	Cash flow statement stars with the opening balance of cash and reaches to the closing balance of cash by proceeding through sources and uses.
3.	**Usage**	Funds flow statement is more useful in assessing the long-range financial strategy.	Cash flow statement is useful in understanding the short-term phenomena affecting the liquidity of the business.

4.	**Schedule of Changes in Working Capital**	In funds flow statement changes in current assets and current liabilities are shown through the schedule of changes in working capital.	In cash flow statement changes in current assets and current liabilities are shown in the cash flow statement itself.
5.	**End Result**	Funds flow statement shows the causes of changes in net working capital.	Cash flow statement shows the causes the changes in cash.
6.	**Principal of Accounting**	Funds flow statement is in alignment with the accrual basis of accounting.	In cash flow statement data obtained on accrual basis are converted into cash basis.

Advantages of Cash Flow Statement

1. It shows the actual cash position available with the company between the two balance sheet dates which funds flow and profit and loss account are unable to show. So it is important to make a cash flow report if one wants to know about the liquidity position of the company.
2. It helps the company in accurately projecting the future liquidity position of the company enabling it arrange for any shortfall in money by arranging finance in advance and if there is excess than it can help the company in earning extra return by deploying excess funds.
3. It acts like a filter and is used by many analyst and investors to judge whether company has prepared the financial statements properly or not because if there is any discrepancy in the cash position as shown by balance sheet and the cash flow statement, it means that statements are incorrect.

Disadvantages of Cash Flow Statement

1. Since it shows only cash position, it is not possible to deduce actual profit and loss of the company by just looking at this statement.

2. In isolation this is of no use and it requires other financial statements like balance sheet, profit and loss etc…, and therefore limiting its use.

Advantages of Fund Flow Statements

A Funds flow statement is prepared to show changes in the assets, liabilities and equity between two balance sheet dates, it is also called statement of sources and uses of funds. The advantages of such a financial statement are many fold.

Some of these are:

1. Funds flow statement reveals the net result of Business operations done by the company during the year.
2. In addition to the balance sheet, it serves as an additional reference for many interested parties like analysts, creditors, suppliers, government to look into financial position of the company.
3. The Fund Flow Statement shows how the funds were raised from various sources and also how those funds were deployed by a company, therefore it is a great tool for management when it wants to know about where and from what sources funds were raised and also how those funds got utilized into the business.
4. It reveals the causes for the changes in liabilities and assets between the two balance sheet dates therefore providing a detailed analysis of the balance sheet of the company.
5. Funds flow statement helps the management in deciding its future course of plans and also it acts as a control tool for the management.
6. Funds flow statement should not be looked alone rather it should be used along with balance sheet in order judge the financial position of the company in a better way.

Disadvantages of Fund Flow Statements

Funds flow statement has many advantages; however it has some disadvantages or limitations also.

Let's look at some of the limitations of funds flow statement.

1. Funds Flow statement has to be used along with balance sheet and profit and loss account for inference of financial strengths and weakness of a company it cannot be used alone.
2. Fund Flow Statement does not reveal the cash position of the company, and that is why company has to prepare cash flow statement in addition to funds flow statement.
3. Funds flow statement only rearranges the data which is there in the books of account and therefore it lacks originality. In simple words it presents the data in the financial statements in systematic way and therefore many companies tend to avoid preparing funds flow statements.
4. Funds flow statement is basically historic in nature, that is it indicates what happened in the past and it does not communicate anything about the future, only

estimates can be made based on the past data and therefore it cannot be used the management for taking decision related to future.

We can conclude that shorter the planning period more relevant is the "Cash Flow Statement and longer the planning period more relevant is the "Fund Flow Statement"

Q) Break-Even Point: Meaning, Assumptions, Uses and Limitations

Break-even point represents that volume of production where total costs equal to total sales revenue resulting into a no-profit no-loss situation.

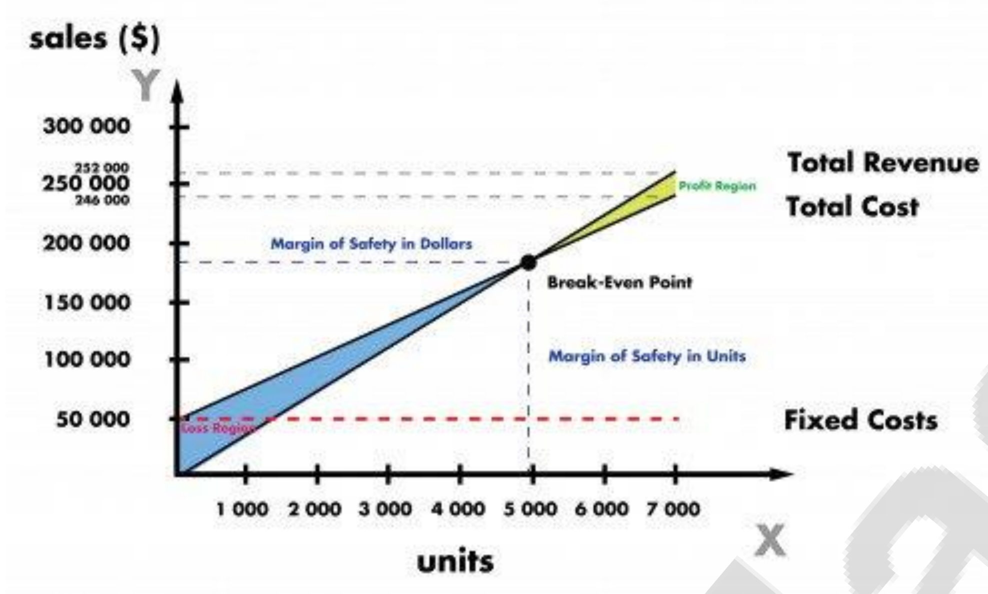
If output of any product falls below that point there is loss; and if output exceeds that point there is profit.

Thus, it is the minimum point of production where total costs are recovered. Therefore, at break-even point.

Sales Revenue – Total Cost

or, Sales – Variable Cost = Contribution = Fixed Cost

It can be concluded that at break-even point the contribution earned just covers the fixed cost and, at levels below the point, contribution earned is not sufficient to match the fixed cost and, at levels above the point, contribution earned more than recovers the fixed cost.



Break-even point can be ascertained by using the following formula:

$$\text{Break-even point (units)} = \frac{\text{Fixed Cost}}{\text{Contribution per unit}}$$

$$\text{Break-even point (sales value)} = \frac{\text{Fixed Cost}}{\text{P / V ratio}}$$

Assumptions Underlying Break-Even Analysis:

The break-even analysis is based on certain assumptions.

They are:

(i) All costs can be separated into fixed and variable components,

(ii) Fixed costs will remain constant at all volumes of output,

(iii) Variable costs will fluctuate in direct proportion to volume of output,

(iv) Selling price will remain constant,

(v) Product-mix will remain unchanged,

(vi) The number of units of sales will coincide with the units produced so that there is no opening or closing stock,

(vii) Productivity per worker will remain unchanged,

(viii) There will be no change in the general price level.

Uses of Break-Even Analysis:

(i) It helps in the determination of selling price which will give the desired profits.

(ii) It helps in the fixation of sales volume to cover a given return on capital employed.

(iii) It helps in forecasting costs and profit as a result of change in volume.

(iv) It gives suggestions for shift in sales mix.

(v) It helps in making inter-firm comparison of profitability.

(vi) It helps in determination of costs and revenue at various levels of output.

(vii) It is an aid in management decision-making (e.g., make or buy, introducing a product etc.), forecasting, long-term planning and maintaining profitability.

(viii) It reveals business strength and profit earning capacity of a concern without much difficulty and effort.

Limitations of Break-Even Analysis:

1. Break-even analysis is based on the assumption that all costs and expenses can be clearly separated into fixed and variable components. In practice, however, it may not be possible to achieve a clear-cut division of costs into fixed and variable types.

2. It assumes that fixed costs remain constant at all levels of activity. It should be noted that fixed costs tend to vary beyond a certain level of activity.

3. It assumes that variable costs vary proportionately with the volume of output. In practice, they move, no doubt, in sympathy with volume of output, but not necessarily in direct proportions..

4. The assumption that selling price remains unchanged gives a straight revenue line which may not be true. Selling price of a product depends upon certain factors

like market demand and supply, competition etc., so it, too, hardly remains constant.

5. The assumption that only one product is produced or that product mix will remain unchanged is difficult to find in practice.

6. Apportionment of fixed cost over a variety of products poses a problem.

7. It assumes that the business conditions may not change which is not true.

8. It assumes that production and sales quantities are equal and there will be no change in opening and closing stock of finished product, these do not hold good in practice.

9. The break-even analysis does not take into consideration the amount of capital employed in the business. In fact, capital employed is an important determinant of the profitability of a concern.

Q) Double Entry System of Bookkeeping and its advantages and disadvantages

Double Entry System of Book-keeping. Double Entry System of Book-keeping refers to a system of accounting under which both the aspects of every transactions are recorded in the accounts involved. In other words, it is a system of recording business transactions which recognizes that each transaction has a dual aspect. Under this system, each transaction is seen as a flow of value from one account to another. The receiving account is debited with the amount and the giving account is credited. Therefore, every debit has equal amount of credit. So the total of all debits must be equal to the total of all credits.

Example. Mr. X sold goods for cash Rs. 10,000 to Mrs. Y. In this case the dual aspects of this transaction for Mr. X and Mr, Y are as follows :

Dual Aspects for Mr. X

1. Receipt of cash Rs. 10,000
2. Forgoing of goods of Rs 10,000

Dual Aspects for Mr. Y

1. Receipt of goods Rs 10,000
2. Payment of cash Rs 10,000

Features of Double Entry System :

1. This system records both aspect of each transaction.
2. All transaction are recorded fully.
3. Under this system, equal debit and credit entries are made for every transactions in two different accounts.
4. Under this system, it is possible to prepare a Trial Balance and check the arithmetical accuracy of the books of the account.
5. Under this system, profit / loss can be found.

6. Balance Sheet can be prepared.

Advantages of the Double Entry System

1. A complete record of all the transactions relating to a business unit are maintained systematically.
2. The financial position of the firm can be ascertained.
3. The arithmetical accuracy of the books of account can be ensured.
4. Location and rectification of error are possible.
5. The profits earned or losses suffered for an accounting' period can be ascertained
6. Amount due to suppliers and due from customers can be easily ascertained.

Advantages of Double Entry System of Book Keeping

1. The most advantageous feature is that you can draw a Trial Balance of your ledger accounts as and when required and know your position of business up-to-date.
2. This system gives you the most accurate and reliable position of your accounts.
3. It facilitates you to compare the business performance of a period with figures of a previous period or with last year corresponding period figures.

Disadvantages of Double Entry System of Book Keeping

1. The accounts can depict the wrong picture when an accountant is not well versed in accounting and debits wrong head of account or entirely reverses a transaction while posting in the ledger accounts.
2. This system requires a number of books to be maintained as compared to the single entry system of bookkeeping.

But, on the whole, this double entry system of book-keeping is the most popular and the most commonly used system of accounts all over the world.

Q) Financial Accounting vs Cost Accounting

Sr No	Financial Accounting	Cost Accounting
1	Records financial data of the organization. So it records all relevant monetary data	Records and summarizes cost information and data. This includes information about labour, materials and various overheads of the manufacturing process.
2	Financial accounting only deals in historical costs (only actual costs and figures)	Cost accounting uses both historical and pre-determined costs (standard costs, estimates etc.)
3	The users of the information provided by financial accounting are both internal and external users	Information provided by cost accounting is only meant for people within the firm like management, employees etc.
4	Financial accounting is mandatory for all firms. Every organization has to keep some record of their financial transactions	Cost accounting is only done by manufacturing firms. And in most cases, it is not mandatory.
5	The emphasis here is on recording the transactions/data and presenting it in the given format.	Other than recording data it also provides a system of cost control of labour, material, overhead costs
6	Financial accounts deal with the business in its entirety. So it provides us with profit or loss for the whole concern	Costing will enable us to get the profit or loss for individual products, process, job etc.
7	In financial accounting, there is no aspect of forecasting. It is simply a record of the financial position of the firm	In Cost accounting, forecasting is possible using some of the budgeting techniques
8	Financial accounting is strictly a positive science. There is rigidity in the process due to legal requirements	Cost accounting is both a positive and normative science.
9	Period of reporting of financial accounting is at the end of financial year.	Reporting under cost accounting is done as per the requirement of management or as-and-when-required basis.

Q) Four Basic Types of Financial Ratios Used to Measure a Company's Performance

Liquidity and the Current Ratio

The most common liquidity ratio is the current ratio, which is the ratio of current assets to current liabilities. This ratio indicates a company's ability to pay its short-term bills. A ratio of greater than one is usually a minimum because anything less than one means the company has more liabilities than assets. A high ratio indicates more of a safety cushion, which increases flexibility because some of the inventory items and receivable balances may not be easily convertible to cash.

Companies can improve the current ratio by paying down debt, converting short-term debt into long-term debt, collecting its receivables faster and buying inventory only when necessary.

Solvency Ratios and Financial Stability

Solvency ratios indicate financial stability because they measure a company's debt relative to its assets and equity. A company with too much debt may not have the flexibility to manage its cash flow if interest rates rise or if business conditions deteriorate.

The common solvency ratios are debt-to-asset and debt-to-equity. The debt-to-asset ratio is the ratio of total debt to total assets. The debt-to-equity ratio is the ratio of total debt to shareholders' equity, which is the difference between total assets and total liabilities.

Profitability Ratios and Margins

Profitability ratios indicate management's ability to convert sales dollars into profits and cash flow. The common ratios are gross margin, operating margin and net income margin. The gross margin is the ratio of gross profits to sales. The gross profit is equal to sales minus cost of goods sold.

The operating margin is the ratio of operating profits to sales and net income margin is the ratio of net income to sales. The operating profit is equal to the gross profit minus operating expenses, while the net income is equal to the operating profit minus interest and taxes. The return-on-asset ratio, which is the ratio of net income to total assets, measures a company's effectiveness in deploying its assets to generate profits. The return-on-investment ratio, which is the ratio of net income to shareholders' equity, indicates a company's ability to generate a return for its owners.

Common Efficiency Ratios

Two common efficiency ratios are inventory turnover and receivables turnover. Inventory turnover is the ratio of cost of goods sold to inventory. A high inventory turnover ratio means that the company is successful in converting its inventory into sales.

The receivables turnover ratio is the ratio of credit sales to accounts receivable, which tracks outstanding credit sales. A high accounts receivable turnover means that the company is successful in collecting its outstanding credit balances.

Q) Financial Management and its scope

1. Financial Management is an integral part of overall management. Financial considerations are involved in all business decisions. So financial management is pervasive throughout the organization.

2. The central focus of financial management is valuation of the firm. That is financial decisions are directed at increasing/maximization/ optimizing the value of the firm.

3. Financial management essentially involves risk-return trade-off Decisions on investment involve choosing of types of assets which generate returns accompanied by risks. Generally higher the risk, returns might be higher and vice versa. So, the financial manager has to decide the level of risk the firm can assume and satisfy with the accompanying return.

4. Financial management affects the survival, growth and vitality of the firm. Finance is said to be the life blood of business. It is to business, what blood is to us. The amount, type, sources, conditions and cost of finance squarely influence the functioning of the unit.

5. Finance functions, i.e., investment, rising of capital, distribution of profit, are performed in all firms - business or non-business, big or small, proprietary or corporate undertakings. Yes, financial management is a concern of every concern.

6. Financial management is a sub-system of the business system which has other subsystems like production, marketing, etc. In systems arrangement financial sub-system is to be well-coordinated with others and other sub-systems well matched with the financial subsystem.

Finance Functions (Scope of Financial Management)
The finance function encompasses the activities of raising funds, investing them in assets and distributing returns earned from assets to shareholders. While doing these activities, a firm attempts to balance cash inflow and outflow.
It is evident that the finance function involves the four decisions viz., financing decision, investment decision, dividend decision and liquidity decision. Thus the finance function includes:

1. Investment decision
2. Financing decision
3. Dividend decision
4. Liquidity decision

1. Investment Decision: The investment decision, also known as capital budgeting, is concerned with the selection of an investment proposal/ proposals and the investment of funds in the selected proposal. A capital budgeting decision involves the decision of allocation of funds to long-term assets that would yield cash flows in the future. Two important aspects of investment decisions are:

i. The evaluation of the prospective profitability of new investments, and
ii. The measurement of a cut-off rate against that the prospective return of new investments could be compared.

Future benefits of investments are difficult to measure and cannot be predicted with certainty. Risk in investment arises because of the uncertain returns. Investment proposals should, therefore, be evaluated in terms of both expected return and risk. Besides the decision to commit funds in new investment proposals, capital budgeting also involves replacement decision, that is decision of recommitting funds when an asset become less productive or non-profitable. The computation of the risk-adjusted return and the required rate of return, selection of the project on these bases, forms the subject-matter of the investment decision.

Long-term investment decisions may be both internal and external. In the former, the finance manager has to determine which capital expenditure projects have to be undertaken, the amount of funds to be committed and the ways in which the funds are to be allocated among different investment outlets. In the latter case, the finance manager is concerned with the investment of funds outside the business for merger with, or acquisition of, another firm.

2. Financing Decision: Financing decision is the second important function to be performed by the financial manager. Broadly, he or she must decide when, from where and how to acquire funds to meet the firm's investment needs. The central issue before him or her is to determine the appropriate proportion of equity and debt. The mix of debt and equity is known as the firm's capital structure. The financial manager must strive to obtain the best financing mix or the optimum capital structure for his or her firm. The firm's capital structure is considered optimum when the market value of shares is maximized.

3. Dividend Decision: Dividend decision is the third major financial decision. The financial manager must decide whether the firm should distribute all profits, or retain them, or distribute a portion and return the balance. The proportion of profits distributed as dividends is called the dividend-payout ratio and the retained portion of profits is known as the retention ratio. Like the debt policy, the dividend policy should be determined in terms of its impact on the shareholders' value. The optimum dividend policy is one that maximizes the market value of the firm's shares. Thus, if shareholders are not indifferent to the firm's dividend policy, the financial manager must determine the optimum dividend-payout ratio. Dividends are generally paid in cash. But a firm may issue bonus shares. Bonus shares are shares issued to the existing shareholders without any charge. The financial manager should consider the questions of dividend stability, bonus shares and cash dividends in practice.

4. Liquidity Decision: Investment in current assets affects the firm's profitability and liquidity. Current assets should be managed efficiently for safeguarding the firm against the risk of illiquidity. Lack of liquidity in extreme situations can lead to the firm's insolvency. A conflict exists between profitability and liquidity while managing current assets. If the firm does not invest sufficient funds in current assets, it may become illiquid and therefore, risky. But if the firm invests heavily in the current assets, then it would loose interest as idle current assets would not earn anything. Thus, a proper trade-off must be achieved between profitability and liquidity. The profitability-liquidity trade-off requires that the financial manager should develop sound techniques of managing current assets and make sure that funds would be made available when needed.

Q) Role of financial manager

Finances are the cornerstone of every business. The prime goal of any organization would be to garner huge profits and this is only possible with proper **management of the finances**. Therefore, effectual **finance management** is imperative for every organization as it leads to enhanced profits and reduction in the operational cost. A **finance manager** plays an important role in the management of a business organization as he manages all the activities related to finance. There are many functions that a **financial manager** is expected to perform. These include:

1. **Estimating the amount of capital required for the proper functioning of the business**

The most basic function of a **finance manager** is the estimation of the capital because funds are required for both long term and short term. The firm requires capital so that it can meet its liability with no delay, benefit from early business opportunities, pay for resources, operational cost etc. Sufficient capital is also required so that the firm can face any crisis like recession and bottleneck.

2. **Devising a capital structure**

For the determination of the capital structure, the **financial manager** must ensure that the earning rate is higher than the rate of interest on the borrowed amount. A fine capital structure is required to minimize operational cost and to maximize the shareholder’s profits.

3. **Sources to raise funds**

For proper **financial management,** it is imperative to find the various sources from where the firm can raise funds. The organisation can raise funds through different sources including equity and preference shares, debentures, banks, financial institutions and other sources. The funds can be raised for short as well as long period.

4. **Acquisition of funds**

While acquiring funds, the **financial manager** needs to follow some basic steps such as legal formalities and documentation required. He might also need to negotiate with the financial institutions. The factors affecting procurement are the market conditions, the policy of the government, investor's choice, and many more.

5. **Utilizing funds**

It is the task of the **finance manager** to ensure that the funds are invested wisely so as to garner maximum ROI. While investing, the firm must take care of safety, profitability, and liquidity of the funds. The funds must be utilized in such a way that the firm does not face its shortage in near future.

6. **Disposing of profits**

Effectual **finance management** involves analyzing the funds that can be invested for proper working of the organization and distributing the rest among the shareholders. The firm's earning must be in such a way that a large proportion can be distributed among the investors.

7. **Managing the available cash**

A **financial manager** needs to manage the cash in such a way that there is neither shortage nor surplus and daily expenses can be met without any hassles. This can be done by forecasting cash inflows and outflows and balancing them. The manager must ensure that sufficient funds are always available to purchase material and meet daily expenses.

8. **Control of Finance**

Finance management involves evaluation and control of the financial performance of an organization. This involves employing finance control techniques, auditing, break-even analysis and analysis of cost. Finally, ROI is measured which deciphers whether the company has incurred profits or loss.

Q) Classification of Accounts and its golden rules

The accounts are classified into three categories:

- Personal accounts
- Real accounts
    - Tangible accounts
    - Intangible accounts

Let us go through them each of them one by one.

Personal Accounts

Personal accounts may be further classified into three categories:

Natural Personal Account

An account related to any individual like David, George, Ram, or Shyam is called as a Natural Personal Account.

Artificial Personal Account

An account related to any artificial person like M/s ABC Ltd, M/s General Trading, M/s Reliance Industries, etc., is called as an Artificial Personal Account.

Representative Personal Account

Representative personal account represents a group of account. If there are a number of accounts of similar nature, it is better to group them like salary payable account, rent payable account, insurance prepaid account, interest receivable account, capital account and drawing account, etc.

Real Accounts

Every Business has some assets and every asset has an account. Thus, asset account is called a real account. There are two type of assets:

- **Tangible** assets are touchable assets such as plant, machinery, furniture, stock, cash, etc.
- **Intangible** assets are non-touchable assets such as goodwill, patent, copyrights, etc.

Accounting treatment for both type of assets is same.

Nominal Accounts

Since this account does not represent any tangible asset, it is called nominal or fictitious account. All kinds of expense account, loss account, gain account or income accounts come under the category of nominal account. For example, rent account, salary account, electricity expenses account, interest income account, etc.

Golden Rules for Debit and Credit for all types of accounts:

Personal Account:

Debit the Receiver

Credit the Giver

Real Account:

Debit what comes in

Credit what goes out

Nominal Account:

Debit all expenses and losses

Credit all incomes and gains

Q) Capital Budgeting or Investment Decision: Meaning, Features and Techniques / Explain ARR and Payback period in detail

The term capital budgeting or investment decision means planning for capital assets. Capital budgeting decision means the decision as to whether or not to invest in long-term projects such as setting up of a factory or installing a machinery or creating additional capacities to manufacture a part which at present may be purchased from outside and so on. It includes the financial analysis of the various proposals regarding capital expenditure to evaluate their impact on the financial condition of the company for the purpose to choose the best out of the various alternatives.

Nature / Features of Capital Budgeting Decisions:

1. Long Term Effect: Such decisions have long term effect on future profitability and influence pace of firms growth. A good decision may bring amazing returns and wrong decision may endanger very survival of firm. Hence capital budgeting decisions determine future destiny of firm.

2. High Degree of Risk: Decision is based on estimated return. Changes in taste, fashion, research and technological advancement leads to greater risk in such decisions.

3. Huge Funds: Large funds are required and sparing huge funds is problem and hence decision to be taken after proper care.

4. Irreversible Decision: Reverting back from a decision is very difficult as sale of high value asset would be a problem.

5. Most Difficult Decision: Decision is based on future estimates/uncertainty. Future events are affected by economic, political and technological changes taking place.

6. Impact on Firms Future Competitive Strengths: These decisions determine future profit or cost and hence affect the competitive strengths of firm.

7. Impact on Cost Structure: Due to this vital decision, firm commits itself to fixed costs such as supervision, insurance, rent, interest etc. If investment does not generate anticipated profit, future profitability would be affected.

Techniques Used in Investment Decision Making

Most commonly used technique in investment decision making are given below:

1. Payback Period Method: It is one of the simplest methods to calculate period within which entire cost of project would be completely recovered. It is the period within which total cash inflows from project would be equal to total cash outflow of project. Here, cash inflow means profit after tax but before depreciation.

Merits of Payback period Method

i. This method of evaluating proposals for capital budgeting is simple and easy to understand, it has an advantage of making clear that it has no profit on any project until the payback period is over i.e. until capital invested is recovered. This method is particularly suitable in the case of industries where risk of technological services is very high.

ii. In case of routine projects also, use of payback period method favors projects that generates cash inflows in earlier years, thereby eliminating projects bringing cash inflows in later years that generally are conceived to be risky as this tends to increase with futurity.

iii. By stressing earlier cash inflows, liquidity dimension is also considered in selection criteria. This is important in situations of liquidity crunch and high cost of capital.

iv. Payback period can be compared to break-even point, the point at which costs are fully recovered but profits are yet to commence.

v. The risk associated with a project arises due to uncertainty associated with cash inflows. A shorter payback period means that uncertainty with respect to project is resolved faster.

Limitations of Payback Period

i. It stresses capital recovery rather than profitability. It does not take into account returns from the project after its payback period.

ii. This method becomes an inadequate measure of evaluating 2 projects where the cash inflows are uneven.

iii. This method does not give any consideration to time value of money, cash flows occurring at all points of time are simply added.

iv. Post-payback period profitability is ignored totally.

2. Accounting Rate of Return (Average Rate of Return – ARR): ARR is a financial ratio used in capital budgeting. The ratio does not take into account the concept of time value of money. ARR calculates the return, generated from net income of the proposed capital investment. The ARR is a percentage return. Say, if ARR = 7%, then it means that the project is expected to earn seven cents out of each dollar invested. If the ARR is equal to or greater than the required rate of return, the project is acceptable. If it is less than the desired rate, it should be rejected. When comparing investments, the higher the ARR, the more attractive the investment. Over one-half of large firms calculate ARR when appraising projects. It is calculated with the help of the following formula:

ARR=Average Profit / Investment

Merits of ARR

a. It is simple, common sense oriented method.

b. Profits of all years taken into account.

c. It considers actual net profit of the project.

Demerits of ARR

a. Time value of-money is not considered

b. Risk involved in the project is not considered

c. Annual average profits might be same for different projects but accrual of profits might differ having significant implications on risk and liquidity

d. The ARR has several variants and that it lacks uniform understanding.

3. Net Present Value (NPV) Method: The best method for evaluation of investment proposal is net present value method or discounted cash flow technique. This method takes into account the time value of money. The net present value of investment proposal may be defined as sum of the present values of all cash inflows as reduced by the present values of all cash outflows associated with the proposal. Each project involves certain investments and commitment of cash at certain point of time. This is known as cash outflows.
Cash inflows can be calculated by adding depreciation to profit after tax arising out of that particular project.

Merits of NPV method:

i. NPV method takes into account the time value of money.

ii. The whole stream of cash flows is considered.

iii. NPV can be seen as addition to the wealth of shareholders. The criterion of NPV is thus in conformity with basic financial objectives.

iv. NPV uses discounted cash flows i.e. expresses cash flows in terms of current rupees. NPV's of different projects therefore can be compared. It implies that each project can be evaluated independent of others on its own merits.

Limitations of NPV Method:
i. It involves different calculations.

ii. The application of this method necessitates forecasting cash flows and the discount rate. Thus accuracy of NPV depends on accurate estimation of these 2 factors that may be quite difficult in reality.

iii. The ranking of projects depends on the discount rate.

Q) Ledger and its need

When all the transactions of a given period have been journalized, the next thing is to classify them according to the accounts affected. All similar transactions must be brought together. For instance, all transactions relating to cash must be put in one place. Similarly, all transactions with a customer or a supplier must be assembled at one place. The book in which this classification is done is called the **ledger**.

The *ledger* is a book which contains a condensed and classified record of all the pecuniary transactions of the business generally brought, transferred or posted from the books of original entry.

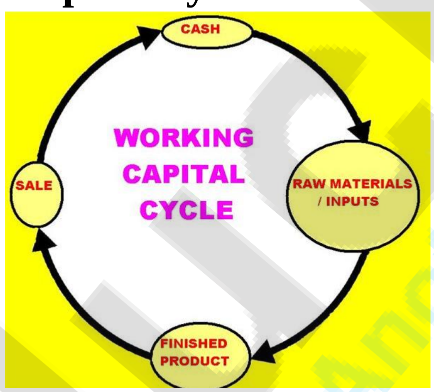
It is important to maintain ledger in every accounting system. It becomes an absolute necessary and comes up with various advantages:

- **Double entry system**: It gets completed only in case the journals are posted into different ledger accounts.
- **Maintain classified accounts**: The particulars of any classified accounts can get revealed only after it is recorded in ledger account.
- **Presentation of statistical information**: The ledger accounts come up with respective balances and it reflects statistical information which can later be viewed by management while taking any decision in business.

- **Keeping permanent record**: Through ledger account it is possible to maintain a permanent record of financial transaction which occurs in a highly classified manner.
- **Prepare trial balance**: It allows in preparing trial balance so that it becomes possible enough to check any arithmetical accuracy which can occur due to recording of financial transaction.
- **Prepare balance sheet**: You can possibly make balance sheet as it is easier to view financial position of company.

When the business balances each account from time to time, it becomes quite prominent that net position of account can be checked. Ledger is the only way through which all kind of entries can be made in journal and sub-journals.

Q) What is a Working Capital Cycle?



The working capital cycle is the time that elapses between investing in a product or service and receiving payment for that product or service. The starting point of the working capital cycle is usually when the business purchase raw materials or hires people for the service. The ending point of the working capital cycle is when the customer makes the payment, regardless of whether such payment comes pre-paid for the service or purchase, payment takes place at time of purchase or obtaining the service, or the payment comes later owing to sale on credit.

For instance, if a company purchase raw material on day 1, manufactures the product on day 7, and sells it on day 15, receiving payment on day 23, the working capital cycle is 23 days. If the company sells the same product on cash basis, the working capital cycle is 15 days.

A simple working capital cycle illustrates the conversion of cash to raw materials and labor, the raw material and labor to finished products, and the finished products to cash. Failure to move each asset through the cycle continuously leads to a breakdown of the cycle, and with it a liquidity crisis where the company cannot purchase additional raw materials or make payments to sustain its operations. This can lead to a shutdown and even bankruptcy.

Uses

The working capital cycle indicates the time that the company has to block money on the product or service before it gets back the money to manufacture additional products and or reinvest some of the profits from the investment for further growth and research.

A company with short working capital cycle usually has a healthy cash flow, and companies with long working capital cycles usually have cash flow difficulties. A lengthy working capital cycle owing to credit sales mean that the company does not have cash to re-manufacture the product even after selling the manufactured product. To sustain operations, the company then has to deploy additional working capital and manufacture a second batch of items without realizing money for the first batch.

Application

Working capital is actually cash tied up with little or no returns, and as such, companies seek to minimize working capital deployment by shortening the working capital cycle.

Good working capital cycle management seeks to balance incoming and outgoing payments by identifying and synchronizing dates of accounts payable and accounts receivable. This entails identifying points where the company has to make more accounts payable, but does not have adequate accounts receivables to match such payables, and then trying to push back accounts payable or bring forward accounts receivables.

The ideal scenario for a company is to affect a perfect balance between accounts payable and accounts receivable, so that the company can maintain zero working capital and still operate smoothly. Companies such as Amazon collect payment before starting the manufacturing process, and as such maintain negative working capital levels. Other companies delay making payment to suppliers of raw materials until getting payment from customer for the finished goods. Such companies always remain flush with funds, and have zero working capital cycle.

Q) Explain budgetary control in detail

Budgetary control is the process by which budgets are prepared for the future period and are compared with the actual performance for finding out variances, if any. The comparison of budgeted figures with actual figures will help the management to find out variances and take corrective actions without any delay.

Objectives of Budgetary Control

The **main objectives of budgetary control** are given below:

1. Defining the objectives of the enterprise.

2. Providing plans for achieving the objectives so defined.

3. Coordinating the activities of various departments.

4. Operating various departments and cost centres economically and efficiently.

:5. Increasing the profitability by eliminating waste.

6. Centralizing the control system.

7. Correcting variances from sit standards.

8. Fixing the responsibility of various individuals in the enterprise.

Advantages of Budgetary Control

Budgetary control has become an important tool of an organization to control costs and to maximize profits. **Some of the advantages of budgetary control** are:

1. It defines the goals, plans and policies of the enterprise. If there is no definite aim then the efforts will be wasted in achieving some other aims.

2. Budgetary control fixes targets. Each and every department is forced to work efficiently to reach the target. Thus, it is an effective method of controlling the activities of various departments of a business unit.

3. It secures better co-ordination among various departments.

4. In case the performance is below expectation, **budgetary control helps the management** in finding up the responsibility.

5. It helps in reducing the cost of production by eliminating the wasteful expenditure.

6. By promoting cost consciousness among the employees, **budgetary control brings in efficiency** and economy.

7. **Budgetary control facilitates centralized control** with decentralized activity.

8. As everything is planned and provided in advance, it helps in smooth running of business enterprise.

9. It tells the management as to where action is required for solving problems without delay.

Disadvantages or Limitations of Budgetary Control

The following are the limitations of budgetary control:

1. It is really difficult to prepare the budgets accurately under inflationary conditions.

2. Budget involves a heavy expenditure which small business concerns cannot afford.

3. Budgets are prepared for the future period which is always uncertain. In future, conditions may change which will upset the budgets. Thus, future uncertainties minimize the utility of budgetary control system.

4. Budgetary control is only a management tool. It cannot replace management in decision-making because it is not a substitute for management.

5. The success of budgetary control depends upon the support of the top management. If there is lack of support from top management, then this will fail.

Q) Difference between Trade Discount and Cash Discount

BASIS FOR COMPARISON	TRADE DISCOUNT	CASH DISCOUNT
Meaning	Trade Discount means the reduction in the list/dealer price of goods at the time of dealing with a buyer of goods	Cash Discount means the reduction in the amount of the Payment receivable from the creditor or payable to debtors
Benefit	Received order in Bulk	Received payment earlier
Time of Discount	At the time of dealing or sale	At the time of payment
Universal to all customer	Yes (if deal prompted on store etc.) Or No (if dealing by company separately with a single distributor)	No
Record in Books	Only recorded on Invoice, not in financial Books	Yes recorded in Financial books
	Trade discount is not to be recorded in ledger accounts.	Cash discount is recorded in the ledger in Discount Received A/c or Discount Allowed A/c.
Taxes	No need to pay taxes on trade discount	Yes because it will provide after sale
Vary with	The number of goods purchased in the given time	Payment made in given time

Q) Differentiate between over-capitalization and under-capitalization

<u>Capitalization</u>

* Capitalization means amount of capital invested in a business.

* Capitalization is used in the case of companies only.

* Capitalization includes all the sources of fund used in an organization.

*Capitalization = Share capital + Preferential share capital

(#) Over-capitalization

* " A corporation is over-capitalized when its earning are not large enough to yield (Provide) a fair return on the amount of stocks and bonds that have been issued , or when the amount of securities outstanding exceeds the current value of the assets "

* The earning are insufficient to pay dividend and interest .

(#) Characteristic of Over-capitalization

* Lower rate of earning

* Lower rate of dividend

* Low market value of shares

(#) Causes Over-capitalization

* Borrowing at high rate of interest

* Over estimation of future earners.

* Assets acquired at inflated price

(#) Disadvantage of Over-capitalization

(*) Disadvantage for company

* Decrease in the share's value

* Difficulty in obtaining capital

* Demand for liquidation

(*) Disadvantage for shareholder

* Shareholder get low dividend

* The market value of share decreases

(*) Disadvantage for society

* Labor may get low wages

* Condition of unemployment can be arise

* It leads to wastage of national resources

(#) Remedies of Over-capitalization

Under the scheme of capital reduction

* Reduction in the rate of interest payable on debenture.

* Reduction in the rate of preference dividend.

* Reduction in number of shares.

*Enhance earning capacity by increase in efficiency of human and non-human resources.

(#) <u>Under-capitalization</u>

" When a corporation earns exceedingly high income on its capital, it is said to under-capitalized "

(#) Causes of under-capitalization

* The assets have been acquired at lower rate

* The company has generated secret reserves by paying lower dividend (Conservative dividend policy) to the shareholder over a number of year.

(#) Indicators of under-capitalization

* Unforeseen increase in earnings.

* High standard of efficiency (borrowing at lower rates of interest)

(#) Effect on shareholder

* The rate of earning per share will go up.

* The value of its equity share in the market will go up.

* Shareholder expect higher dividends regularly.

(#) Advantage of under-capitalization

* High dividends

* Company get finance or loans easily.

* It enhance the opportunity and benefit for employees.

(#) Disadvantage of under-capitalization

* Government interference
It may attract government control and higher taxation.

* Negative massage to consumer
It may give the consumers a feeling that they are being exploited by the company

(#) Remedies of under-capitalization

* Issue of bonus shares
Firm may Convert reserve into shares or reduce dividend per shares and overall rate of earning.

* Issue of shares and Debenture to public

Q) Different Categories of Financial Ratios

Financial ratios help to provide an economic overview of a business.

Financial ratios are parameters that owners of a company need to check along with current or potential investors who can understand the financial health of a company overall as well as conditions under different categories. It is also imperative to track financial ratios periodically, which showcase trends and patterns. There are five main types of financial ratios discussed here, along with significances of each. Evert category focuses on specific performance parameters.

Ratios also prove useful for business analysts, merchant services and lenders who can understand the financial standing and the stability of a company accordingly. Financial ratios tend to be time sensitive; they showcase picture of financial health of a business at a given time period. It is best that financial ratios are used and ratio analyses done in a periodic and consistent manner.

These are five main categories of financial ratios:

- **Solvency and liquidity ratios**

The liquidity or solvency ratios help a firm to focus on its ability to pay off short term debts and similar obligations. These focus on the current liabilities and assets of a firm as showcased on a balance sheet.

The common liquidity ratios are quick ratio, current ratio and burn rate or interval measure. Quick ratio, as per the name, means the amount of money available as per nearest terms, for paying off current liabilities. Current ratio is a less stringent but a similar ratio of evaluating liquidity. The burn rate on the other hand, measures the length of time in which a business can continue as well as the difference between current expenses and current income. This measure is relevant for startup ventures as they tend to lose money at the beginning of doing business.

Burn rate helps to answer questions regarding the length of time that a business would be able to spend more than what it earns or sustaining a business.

- **Debt or financial leverage ratios**

Such ratios help a firm to focus on their ability to meet debt obligations that are long term. We look at long term liabilities of a firm that showcase on the balance sheet like bond products.

A common financial leverage ratio is total debt ratio or debt/equity ratio. Other similar ratios in this category are long term debt ratio, fixed charge coverage ratio, and times interest earned ratio, cash coverage ratio and so forth.

The ratios have differences but in general financial leverage ratios talk about different aspects such as the financial health of a company or the way shareholder equity is quantified.

- **Asset turnover or efficiency ratios**

The turnover or asset efficiency ratios talk about efficiency in the way a firm uses the assets in producing sales. The ratios focus on the income statement of sales or balance sheet of assets.

Common asset efficiency ratios are several such as an inventory turnover ratio, days' sales in receivables ratio, receivables turnover ratio, fixed asset turnover ratio, net working capital ratio, total asset turnover ratio.

The asset efficiency ratios are helpful in describing how a business runs from a dynamic point of view. These ratios indicate how well a business is run – the rate at which products sell, the length of time customers takes to make payment, capital that remains tied in inventory and so forth.

- **Profitability ratios**

Profitability ratios showcase ability of a firm in generating profit as well as returns on equity and assets. These indicate how well a firm uses the assets and manages operations. These ratios showcase efficiency in using assets as well as managing operations. Basic questions such as profitability of a business or measuring up to competitors are what are answered by these ratios.

- **Market value ratios**

These ratios such as price/earnings and book value to share value as well as dividend yield are usually shown by publicly traded companies. There are several ratios that showcase the market value of a company which also relate to stock prices and publicly traded companies

Q) Difference between Debtors and Creditors

Basis for Comparison	Debtors	Creditors
Meaning	Debtors are the parties who owes debt towards the company.	Creditors are the parties to whom the company owes a debt.
What is it?	It is an account receivable.	It is an account payable.
Status	Assets	Liabilities
Discount	Allowed to debtors.	Received from creditors.
Provision for doubtful debts	Created on debtors	Not created on creditors.

Q) What is Goods, Proprietor, Capital, Assets, Liabilities, Drawings and Bad Debt

Goods:

The things which are bought and sold by business are called goods. Goods maybe raw material work in progress of finished goods. In accounting, when goods are purchased it is written as purchases. When goods are sold it is written as sales. It is written as a stock if remain unsold at the end of the year.

Proprietor:

The person who invests capital in the business and entitled to have all profits and losses of the business is called proprietor or owner of the business. The nature of proprietor depends upon the type or nature of the business organization. In a sole trade business, sole trader is a proprietor, in a partnership firm, partners or proprietor and in company shareholders are proprietors.

Capital:

The amount of cash, goods or assets which is initially invested by proprietor while commencing business is called capital. It is invested to earn profits. In other words, the excess of assets over liability is capital.

Assets:

All the resources of business having economic value are called assets. These resources help the business to earn a profit and have future value. These are important for running a business and are in the possession of businessman. These are of two types: –

a. Fixed assets

The assets which are used by business for a long time are called fixed assets or non-current assets. These are continued to be used by the business for a period of more than one year. For example:- land ,building ,plant, machinery ,furniture ,vehicle etc.

b. Current assets

The assets which are used up in one year or easily get converted into cash in one year are called current assets. For example:- raw material, finished goods, debtors, cash balance and bank balance etc.

Liabilities:

The amount which business owes to others is called its liabilities. There is a certain amount which business is under obligation to pay. There are two types of liabilities: –

a. Long-term liabilities

Those liabilities which are usually payable after a period of 1 year. Long-term loans from Financial Institutions, debentures issued by companies etc.

b. Short-term liabilities

These are those which are payable within one year. For example creditors, bank overdrafts etc.

Drawings:

Drawings refers to the act of withdrawing cash or assets from the company by the owner(s) for personal use.

Drawings can occur by withdrawing cash from a business account, but can also include anything that is considered a business asset, such as products or equipment that is removed from the business for personal use by the owners.

Any type of drawings reduce the capital or owner's equity of a business, so it is important to keep track of these drawings and manage them within your accounts. However, drawings are not considered a business expense.

Bad Debt:

Bad debt is a loss that a company incurs when credit that has been extended to customers becomes worthless, either because the debtor is bankrupt, has financial problems or because it cannot be collected.

Q) Types of Leverage

On the basis of nature of risk associated with the investing and financing activities of a firm, leverage can be divided or classified as follow:

1. Operating Leverage

Operating leverage may be defined as the firm's ability to use fixed operating costs to magnify the effect of changes in sales on its earnings before interest and tax. The relationship between contribution margin and earnings before interest and tax (EBIT) is called degree of operating leverage. It may be defined as the rate of changes in EBIT due to the change in the rate of sales. The firm operating with high fixed operating cost has higher degree of operating leverage. Higher levels of risk are attached to higher degree of leverage. High operating leverage is good when sales are increasing and bad when they are falling.
Operating leverage is used to measure the business risk. Business risk is the risk of

the firm not being able to cover its fixed operating costs.

2. Financial Leverage

Financial leverage is related with the financing activities of a firm. The fixed return sources of capital influence the earning of variable return sources. The effect is known as financial leverage.

The use of fixed charge capital is known as financial leverage. If there is no fixed charge capital, there is no financial leverage. The proper utilization of fixed charged capital like debentures, bonds, bank loan and preference share capital is measured by financial leverage. The firm having more debt capital and preference share capital in its capital structure has higher degree of financial leverage and greater amount of risk.

Financial leverage is used to measure the financial risk. Financial risk refers to the risk of the firm not being able to cover its fixed financial costs.

3. Combined Leverage

The combination of operating leverage and financial leverage is called total leverage or combined leverage. Operating leverage measures operating risk whereas financial leverage measures financial risks. Total leverage or combined leverage measures total risk of the business.

Operating leverage is measured by the percentage change in earnings before interest and tax due to percentage change in sales whereas financial leverage is measured by percentage change in earning per share due to percentage change in earnings before interest and tax.

Q) What is Weighted Average Cost (WAC)?

In accounting, the Weighted Average Cost (WAC) method of inventory valuation uses a weighted average to determine the amount that goes into inventory. The weighted average cost method divides the cost of goods available for sale by the number of units available for sale.

Weighted Average Cost (WAC) Method Formula

The formula for the weighted average cost method is as follows:

$$\text{WAC per unit} = \frac{\text{Cost of goods available for sale}}{\text{Units available for sale}}$$

Where:

- **Costs of goods available for sale** is calculated as beginning inventory value + purchases.
- **Units available for sale** are the number of units a company can sell, or the total number of units in inventory.

Q) Capital gearing ratio

Capital gearing ratio is the ratio of capital with fixed return (i.e. preference share capital plus long term liabilities) to capital with variable return (i.e. ordinary share capital).

The total capital employed of a company comprises of three main segments: equity, preference share capital and long term loans. Equity holders (i.e. ordinary shareholders) are paid a dividend that varies each year with the volume of profits made. Ordinary shareholders are therefore said to have a variable return. On the other hand, both the preference shareholders and long term lenders are paid a fixed rate of return regardless of the level of the company's profits. The capital provided by these two is therefore said to have a fixed return.

Formula:

The formula of capital gearing ratio is given below:

Capital gearing ratio = Common stockholders' equity/Fixed cost bearing funds

Q) What is Cost of Equity?

Cost of Equity is the rate of return a shareholder requires for investing equity into a business. The rate of return an investor requires is based on the level of risk associated with the investment, which is measured as the historical volatility of returns. A firm uses cost of equity to assess the relative attractiveness of investments, including both internal projects and external acquisition opportunities.

Q) What is Window Dressing?

Window dressing is a technique used by companies and financial managers to manipulate financial statements and reports to show more favorable results for a period. Although window dressing is illegal or fraudulent, it is slightly dishonest and is usually done to mislead investors.

Companies typically window dress their financial statements by selling off assets and either purchasing new assets or using this money to funds other operations. This way the cash balance on the balance sheet appears to be at a normal amount.

Unfortunately, this strategy can only fool novice investors. Experienced investors can analyze the statement of cash flows and long-term assets to see that the company is funding current operations by selling off assets.

Example

Window dressing is probably most commonly found in investment brokers and mutual fund houses. Mutual fund managers often sell off poor performing stock and other investments near the end of a period and use the money to buy high performing stock. This way new investors see the portfolio of high performing stock and want to invest. Obviously, this is only a short-term strategy for novice investors. Any experienced investor will analyze portfolio trends over the past few periods to see if the fund's managers are investing wisely.

In short, window dressing is a short-term strategy to make financial statements and financial portfolios appear more consistent and desirable than they really are. Although window dressing does not amount to fraud in most circumstances, it is usually done to mislead investors from the true company or fund performance.

Q) Time Value of Money

Time Value of Money –

Shareholders of a business make sacrifices by investing funds into the business now, to reap its benefits in the future, either as dividend along the years or increase in share prices in the future. However, the expected future benefits are uncertain and therefore they expect a return on invested capital to compensate for the waiting period. A rational investor will chose to invest the money elsewhere or consume it if he is not adequately compensated.

A similar situation arises in case of acquisition of assets by a firm. A firm requires immediate cash to acquire an asset today but the benefit from the asset will be received in the future. This affects the future cash flow over the life of asset. This leads to the study of time value of money.

While taking financial decisions a financial manager compares the present value of total cash inflows with the total cash outflows associated with a project/proposal to determine its profitability.

Concept of Time Value of Money

The actual worth of money available at present time is more than its worth in the future due to potential earning capacity of money.

Therefore, given a choice of receiving a certain sum of money today or in the future, a rational person will always choose to receive the money now as it has more value today than in the future. This phenomenon is known as time preference of money.

Reasons for Time preference of Money –

- The future is uncertain and involves risk.
- People prefer to satisfy present needs as compared to future goals.
- Due to potential earning capacity of money as the same money can be invested elsewhere and different opportunities can be explored.

Components of Time value of Money –

- Present Value (PV)
- Future Value (FV)
- Interest – Simple or Compound (i)
- Amount (A)
- Annuity – Fixed amount of money received/paid for a particular period of time.
- Time Period – (n)
- Perpetuity – An annuity with infinite time period.

Q) Triple Column Cash Book:

In **Triple Column Cash Book** here is three column in the cash book because every Businessman has a minimum of one current account in the bank. It is a very convenient way for him to get paid by cheque and make payment to others by cheque. So, he has to record these payments and receipts in the cash book for this an additional column will require name bank column. So now total three column will be required to record proper payment and receipts in the cash book these are shown below

1. Cash Column
2. Bank Column
3. Discount Column

A specimen of triple Column Cash Book shown below:

Page No:___

Dr. (Receipts) CASH BOOK Cr. (Payments)

Date	Description	VN	PR	Disc	Cash	Bank	Date	Description	VN	PR	Disc	Cash	Bank

The triple column cash book has 7 columns on both debit and credit sides. The purpose of each column is briefly explained below:

1. **Date:** The date column is used to enter the transaction date.
2. **Description:** The description column is used to write the name of the account to be debited or credited in the ledger as a result of cash or bank transaction.
3. **Voucher number (VN):** A voucher is a document in support of a transaction. The serial number of the voucher is entered in this column.
4. **Posting reference (PR):** Each account in the ledger is assigned a unique numbered. The number each ledger account that is written in description column is entered in PR column.
5. **Discount:** The amount of discount allowed is recorded on debit side and the amount of discount received is recorded on credit side in discount column. The totals of debit column and credit column are posted to discount allowed account and discount received account respectively.

6. **Cash:** The amount of cash received (net of any discount allowed) is entered on the debit side and the amount of cash paid (net of any discount received) is entered on the credit side in cash column. This column is totaled and balanced like a ledger account.
7. **Bank:** The amount of all receipts and payments made by the bank account are entered in bank column of the cash book. This column is also totaled and balanced like a ledger account.

Q) Contra entry

If a transaction requires entries on both the debit and the credit sides simultaneously, it is called 'Contra entry'.

Usually, the contra entries will appear in the following occasions.

a. When an account is opened with a bank.
b. The firm's cash is deposited in the bank.
c. The cash is withdrawn from bank for office use.
d. The cheques received from debtors, are deposited in the bank.

In transactions a&b, the cash balance available with the firm is decreased, the cash in bank is increased. In transaction 'c', the cash in the bank is decreased and the cash in the firm is increased.

Q) What are the types of cash books in accounting?

In Cash book, we will record the all-cash transaction of the business. This book keeps all cash payment and cash receipts. It is the book of original entries because first of all, we record the all-cash transaction in this book and then posted these transactions into the various ledger accounts.

Here are the three type of Cash Books shown below:

1. Single Column
2. Double Column
3. Triple Column

1. Single Column:

This type of cash book is very simple because it is similar to the cash account. it has only one column on both sides. Debit side of cash book shows the all receipt and credit side shows all the payment made.

Dr. **Cash Book** Cr.

Receipts					Payment				
Date	Particulars	V No.	L. F.	Amount (Rs)	Date	Particulars	V. No.	L. F.	Amount (Rs)

Read More and check out examples

2. Double Column:

Double Column Cashbook has a two account column on both sides of the cash book. it is three Type shown as below:

1. Discount and Cash Column
2. Bank and Cash Column
3. Discount and Bank Column

Cash Book is an original entry book So we need to record full transaction but in single column cash book, it is not possible to record properly of those cash transactions which are including discount account also. So we need **discount and cash column cash book**.

For example, Received cash from Pawan for Rs 9900/- and allow discount Rs 100/-.

The journal entry of this transaction will be

Cash A/c Dr. 9,900

Discount A/c Dr. 100

To Pawan a/c 10,000/-

In Single column cash book, it not possible to record full transaction because we did not have any column for recording the amount of discount. So we have to prepare double column cash book.

Cash Book with Bank

Dr. Cr.

Receipts						Payment					
Date	Particulars	V No.	L. F.	Cash Rs.	Bank Rs.	Date	Particulars	V. No.	L. F.	Cash Rs.	Bank Rs.

Read More and check out examples.

3. Triple Column

Every Businessman has a minimum of on current account in the bank. it is a very convenient way for him to get paid by cheque and make payment to others by cheque. So, he has to record these payments and receipts in the cash book for this an additional column will require name bank column. So now total three column will be required to record proper payment and receipts in the cash book these are shown below

1. Cash Column
2. Bank Column
3. Discount Column

Triple Column Books

Cash Book

Dr. Cr.

Receipts							Payment						
Date	Particulars	V No.	L. F.	Disc. All.	Cash Rs.	Bank Rs.	Date	Particulars	V. No.	L. F.	Disc. Rec.	Cash Rs.	Bank Rs.