**STUDY MATERIAL**

FINANCIAL

MANAGEMENT

**(Third Year**

**B.Sc. Hospitality and Hotel Administration)**

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CERTIFICATE

*This is to certify that Mr. / Ms ...................................................................*

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**FINANCIAL MANAGEMENT (BMH 307)**

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TOPIC 1

TOPIC 1

FINANCIAL MANAGEMENT – MEANING AND SCOPE

MEANING OF BUSINESS FINANCE

The subject of finance has been traditionally classified into two classes:-

a)Public finance

b)Private Finance

Public finance deals with requirements, receipts, and disbursements of funds in the case of governmental institutions. (state/central govt.)

Private Finance is concerned with requirements, receipts and disbursement of funds in the case of an individual, a profit making business organization, and a non-profit making business organization, and a non profit organization, for eg: a cooperative society.

Thus private finance is divided into 1)Personal finance, 2) Business Finance,

3)Finance for non-profit organizations.

Business finance is concerned with financial management of profit seeking business organizations engaged in all types of activities. According to Guthmann and Dougall, “Business finance can be broadly defined as the activity concerned with planning, raising, controlling and administering the funds used in business. “Thus business finance may be said to deal with acquisition if funds, use of funds, and distribution of profits by a. Business organization.

The scope of business finance can be studied in terms of

Functions performed

Relationships with other activities

Approaches to business finance

Meaning and Definition of Financial Management

Financial Management is that specialized function of general management which is related to the procurement of finance and its effective utilization for the achievement of common goal of the organization. It includes each and every aspect of financial activity in the business. Financial

Management has been defined differently by different scholars. A few of the definitions

are being reproduced below:-

“Financial Management is an area of financial decision making, harmonizing individual motives and enterprise goals”

Weston and brigham.

“Financial management is the application of the planning and control functions to the finance function.”

***Howard and Upon***

“Financial Management is the operational activity of a business that is responsible for obtaining and utilising the funds necessary for efficient operation.’

From the above definitions, it is clear that financial management is that specialized activity which is responsible for obtaining and effectively utilizing the funds for the efficient functioning of the business and, therefore, it includes financial planning, financial administration and financial control.

Functions of Financial Management

Finance function for the sake of convenience may broadly be classified into two groups i.e., executive finance function and incidental finance functions. The executive finance functions are so called because they require administrative skill in planning, execution and control of financial activities. On the other hand incidental finance functions are so called because they do not require any specialized administrative skill and for the most part they cover routine work, mainly clerical that is necessary to carry out the executive decisions. We shall discuss hereunder both the finance functions of financial management in detail

(A)Executive Finance Functions

Executive finance functions include all those financial decisions of importance which requires specialised administrative skill. Some of the executive functions are given below:

**1.Financial Forecasting:** The first and foremost function of financial management is to forecast the financial needs of the concern. In the initial

Stage, it is done by promoters but in a going concern , it is generally performed by the executive chief or bye the office in charge of the finance-department in a large scale enterprise. In estimating the financial requirements of the concern help of various budgets i.e, sales budget, production budget etc. Prepared by the concerned department of the finn. Profit and Loss account and Balance Sheet and other related data is sought.

2. **Investment policy decisions** or Establishing Asset-Management policies. In order to estimate and arrange tor cash requirements of and enterprise, it is very necessary to decide how much cash will be invested in fixed(non-cash) assents and how much in short term or current assents which are normally convertible into cash within a year. It also decides upon the kind and coverage of insurance that a company may carry. The investment decision involving field assets is known, in the financial literature, than as capital budgeting. The financial decision in regard to the current assets is know has working capital management. The investment policy of fixed and current assets is popularly known as `Asset-management –policy`-Establishing a sound asset- management-policy is a prerequisite to successful financial management.

No doubt the financial manager in deciding upon the asset management policies seeks cooperation of marketing executive in making decisions involving the carrying of inventories of finished goods and credit policy etc. and that of the production manager in making decisions concerned with the carrying of inventories of raw materials and factory supplies, purchases etc.

3.**Dividend policy Decision** or Allocution of Net profit. How to allocate the net profits of the concern is the another problem before the financial managers, after paying all taxes the available net profits of the concern can be allocated for three purposes-(a) For paying dividends to the shareholders of the company as a return upon this investment (b) For distributing bonus to the employees and company’s contribution to other profit sharing plans, and (c) retention of profits for the expansion of business. As far as. The second alternative is concerned, the amount to be paid to employees is generally fixed by statutes or on contractual basis and therefore, there is no problem in allocating profits for that purpose. But a considerable attention is to

be paid in so far as first and third alternatives are concerned namely the dividends to be distributed to the shareholders and the amount be retained for future expansion plans, which course should be followed-dividend or retention? One important element in dividend decision is, therefore, the dividend payout ration i.e. much of the net profits should be paid out to the shareholders. It will depend upon the preference of shareholders, investment opportunities available within the firm and the factors determining dividend policy in practice.

4. **Cash Flows and Requirements.** It is the prime responsibility of the financial manager to see that an adequate supply of cash is available at proper time or the smooth running of the business, A good financial executive should ensure that cash inflows and outflows must be continuous and uninterrupted. Inflow of cash originates in sale and cash outflows or cash requirements are closely related to volume of sales. Here the financial manager is to decide how-‘much cash he must retain to meet the current obligations so that there would be no idle cash balance earning nothing for the company. But there is a dilemma as inflow of cash is not precisely predictable and seldom oil set one another. Therefore, the financial manager must maintain a balance between inflow and outflow of cash to pay his bills on time. The more he keeps cash in reserve to protect the company against risks associated with inability to pay bills on time, the more he loses returns on idle cash. It is certain a dilemma of liquidity vs. Profitability.

5.**Deciding Upon Borrowing Policy,** livery organization plans for the expansion of the business for which he requires additional resources. Personal resources being limited, the cash must be arranged by borrowing money, either from commercial banks, and other financial institutions or I. Floating new debentures or by issuing new shares. The financial manager, at this juncture, will take a decision abut the lime when the funds from outside sources are needed, the source from which they are to be receive, how long they will be needed and from what source they will be repaid. Obviously, it is a very important function of financial manage. He will have to decide the financing mix or capital structure or leverage. It means he should take a decision that may carry an ideal proportion he would like to maintain keeping

Various relevant points into mind such as cost of different types of capital return expected, the financial risks involved etc.

6.**Negotiations for New Outside Financing.** Finance function does not stop with the decision to undertake outside financing; it extends towards carrying on negotiations from the outside financing agencies to arrange for it Finances are needed by an establishment to meet its shot- term and long-term requirements. The financial manager must asses short and long term financial requirements of the organisation and start negotiations for raising these funds. It requires considerable planning because the source are to be tackled in advance keeping in view the alternative source and sounded in a manner that in case on one fails, the other should be available. lie must keep open the credit lines.

7. **Checking upon Financial Performance.** The financial manager is under an obligation to check the financial performance of the funds invested in the business. It required retrospective analysis of the operating period to evaluate the efficiency of financial planning. An unbiased assessment of financial performance shall be great value to the business in improving the standards techniques, and procedures of financial control.

The executive finance functions discussed above are interrelated. Therefore, a change in decision with regard to one of the functions is likely to affect change in decision concerning some or ail others

B. Incidental Finance Functions

We have already discussed the executive finance functions in the foregoing paragraph. Now we shall discuss the-various incidental finance functions. Incidental finance functions are those functions of clerical or routine nature which are necessary for the execution of decisions taken by the executives. Some of the important incidental finance functions are:

Supervision of cash receipts and disbursements and safe guarding of cash balance.

Proper custody and safeguarding of the important and valuable papers, securities and insurance policies.

Taking care of all mechanical details of financing.

Record-keeping and reporting.

Cash planning and credit management

TOPIC 2

FINANCIAL STATEMENT-ANALYSIS AND INTERPRETATION

Introduction

The ability to gain insights through the study of financial statements is vital to sound financial decision making. The basic data with which the analyst must work are found in the financial statements. So the ability to understand, interpret, and use this information is basic to an understanding of finance.

Meaning

Accounting process involves recording, classifying, and summarizing various business transactions. The day –to –day transactions of a business are recorded in different subsidiary books. These transactions are posted into various ledger accounts and the balance are taken out at the end of a financial period. The aim of maintaining various records is to determine profitably of the enterprise from operation of the business and also to find out its’s financial position. Financial statements are the outcome of summarizing process of accounting. Financial statements, essentially, are the inter firm report, presented annually and reflect a division of the life of an enterprise into more or less arbitrary accounting periods-more frequently a year.

Definition

John N. Myer “The financial statements provide a summary of the accounts of a business enterprise, the balance sheet reflecting the assets, liabilities and capital as on a certain date and the income statement showing the results of operation doing a certain period”.

Accounting to Smith & Ashburne “financial statements are the outcome of preparing financial accounts and these statements reveal financial position and profitability of the concern and the utilization of retained earnings”.

Objective

Diverse groups of people are keenly interested in the information found in the firm’s financial statements. They study the statements carefully interpreting the information that relates to the partial interest in the company.

The object of all these analyses is some son of evaluation of the firm’s performance. The following are the objective of financial statements.

It shall provide information, within the. Limits of financial accounting, that is useful to present and potential investors and creditors in making rational investment and credit decisions.

To provide reliable financial information about economic resources and obligation of a business enterprise

To provide reliable information about changes in net resources of an enterprise that result from the profit directed activities.

To provide financial information that assists in estimating the earnings of potential of the enterprise:

To provide other needed information about changes in economic resources and Obligations.

To disclose to the extent possible, other information related to the financial statement that is relevant to statement users.

Various Financial Statements

Generally, following financial statements are prepared

Income Statement (or Profits and Loss Account). Income statement is

prepared to determine the operational position of the concern. It is a statement of revenues earned and the expenses incurred for earning that revenue. If there is excess of revenues over expenditures it will show a profit and if the expenditures are more than the income then there will be a loss. The income statement is prepared for a particular period, generally a year.

***Balance Sheet:*** The American Institute of Certified Public Accountants defines Balance Sheet as, “A tabular statement of summary of balances (debits and credits) earned forward after an actual and constructive closing of books of account and kept according to principles of accounting.”

The balance sheet is one of the important financial statement depicting. The financial strength of the concern. It shows on the one hand the properties that it utilizes and on the other hand the sources of those properties. The balance sheet shows all the assets owned by the concern and all the liabilities and claims it owes to owners and outsiders. The balance sheet is prepared on

a particular date. The right hand side shows properties and assets. Normally there is no particular sequence for showing various assets and liabilities. The Companies Act, 1956 has prescribed a particular form for showing assets and liabilities in the balance sheet for companies registered under this act. These companies are also required to give figures for the previous year along with the current year figures.

***3.Statement of Retained Earnings.*** A statement retained earnings is also known as Profit and Loss Appropriation Account or Income disposal Statement. As the name suggests it shows appropriation of earnings. The previous year’s balance is first brought forward. The net profit during the current year is added to this balance. On the debit side, appropriations like interim dividend paid, proposed dividend on preference and equity share capital, amounts transferred to debenture redemption fund, capital redemption fund, general reserve, etc. are shown. The balance in this account will show the amount of profit retained in hand and carried forward.

The appropriations cannot be more than the profits, so this account will not have a debit balance. There cannot be appropriations without profits.

**4.Funds Flow Statement.** The funds flow statement is designed to analyses the changes in the financial condition of a business enterprise between two periods. The word ‘Fund’ is used to denote working capital. This statement will show the sources from which the funds are received and the uses to which these have been put. This statement enables the management to have an idea about the sources of funds and their uses for various purposes. This statement helps the management in policy formulation and performance approval.

5. **Cash Flow Statement.** A statement of changes in the financial position of a firm on cash basis is called Gash Flow Statement. It summarizes the causes of changes in-cash position of a business enterprise between dates of two balance sheets. This statement is very much similar to the statement of changes in working capital i.e. funds flow statement. A cash flow statement focuses attention on’ cash changes only. It describes the sources of cash and its uses.

6. **Schedules.** A number of schedules are prepared to supplement the information supplied in the balance sheet. The schedules of investments,

Fixed Assets, Debtors, etc are prepared to give derails about these transactions. A banking company may prepare a detailed schedule of `Advances` sp as to supplement the balance sheet information. All these schedules are used as part of financial statement.

Techniques of Financial Analysis

A Financial Analyst can adopt one or more of the following techniques/ tools of analysis A financial analyst can adopt one or more of the following techniques/tools of financial analysis.

Comparative Financial statements

Common- size financial statements

Trend Percentages

Funds Flow Analysis

Cash Flow Analysis

CVP Analysis

Ration Analysis

Comparative Financial statements

Comparative financial statements are those statements which have been designed in a way so as to provide time perspective to the consideration of various elements of financial position embodied in such statements. In these statements figures for two or more periods are placed side by side to facilitate comparison.

Both the Income Statement and Balance sheet can be prepared in the form of comparative Financial statements.

Comparative Income statement

The Income statement discloses not profit or net loss on account of operations. A Comparative Income statement will show the absolute figures for two or more periods, the absolute change from one period to another and if desired the change in terms of percentages. Since the figures for two or more periods are shown side by side, the reader can quickly ascertain whether sales have increased or decreased. Whether the cost of sales has increased or decreased etc... Thus only a reading of data included in

Comparative Income Statements will be helpful in deriving meaningful conclusions

Comparative Balance sheet.

Comparative Balance sheet as on two or more different dates can be used for comparing assets and liabilities and finding out any increase or decrease in those items; thus, while in a single Balance Sheet the emphasis is on present positions, it is on change in the comparative Balance sheet. Such a Balance Sheet is very useful in studying the trends in an enterprise.

(2) Common-size Financial Statements.

Common size financial statements are those in which figures reported are converted into percentages to some common base. In the Income Statement the sale figures is assumed to be 100 and all figures are expressed as a percentage of this total.

(3) Trend Percentage

Trend percentages are immensely helpful in making a comparative study of the financial statements for several years. The method of calculating trend percentages involves the calculation of percentage relationship that each item bears to the same item in the base year. Any year may be taken as the base year. It is usually earliest year. Any intervening year may also be taken as the base year. Each item of base year is taken as 100 and on that basis the percentages for each of the items of each of the years are calculated. These percentages can also be taken as Index numbers showing relative changes in the financial data resulting with the passage of time.

The method of trend percentages is a useful analytical device for the management since by substituting percentages for large amounts, the brevity and readability are achieved. However, trend percentages are not calculated for all of the items in the financial statements. They are usually calculated only for major items since the purpose highlight important changes.

(4) Funds flow Analysis

Funds flow analysis has become an important tool in the analytical kit of financial analysts, credit granting institutions and financial managers. This is because the Balance Sheet of a business reveals its financial status financial status at a particular point of time. It does not sharply focus those major. Financial transaction which have been behind the Balance sheet changes.

Funds flow analysis reveals the changes in working capital position. It tells about the sources from which the working capital was obtained and the purpose for which it was used. It brings out in open the changes which have taken place behind the Balance Sheet. Working capital being the life – blood of the business such an analysis is extremely useful.

(6) Cost- Volume –Profit Analysis

CVP analysis is an important tool of profit planning. It studies the relationship between cost, volume of production, sales, and profit. Of course It is not strictly a technique used for analysis of financial statements. However, it is an important tool for the management for decision making.

PROBLEM-1

The balance Sheets of S&C). and k &Co. Are given as follows:

Prepare a Common size balance Sheet.

BALANCE SHEET

As on Dec. , 31,2009

|  |  |  |
| --- | --- | --- |
| Liabilities | S & Co | K & Co. |
|  | Rs. | Rs. |
| Preference Share Capital | 1,20,000 | 1,60,000 |
| Equity Share Capital | 1,50,000 | 4,00,000 |
| Reserve & Surplus | 14,000 | 18,000 |
| Long term loans | 1,15,000 | 1,30,000 |
| B/P | 2,000 | - |
| Sundry Creditors | 12,000 | 4,000 |
| Outstanding Expenses | 15,000 | 6,000 |
| Proposed dividend | 10,000 | 90,000 |
|  | 4,38,000 | 8,08,000 |
| Land and Building | 80,000 | 1,23,000 |
| Plant and Machinery | 3,34,000 | 6,00,000 |
| Temporary Investment | 1,000 | 40,000 |
| Inventories | 10,000 | 25,000 |
| Book Debts | 4,000 | 8,000 |
| Prepaid expenses | 1,000 | 2,000 |
| Cash and Bank Balance | 8,000 | 10,000 |
|  | 4,38,000 | 8,08,000 |

PROBLEM-2

Following are the Income Statements of a company for years ending Dece.31,1981 and 1982; Prepare a common size income statement

|  |  |  |
| --- | --- | --- |
|  | 1981  (Rs. In ‘000’) | 1982  (Rs. in ‘0000’) |
| Sales | 500 | 700 |
| Miscellaneous Income | 20 | 15 |
|  | 520 | 715 |
| Expenses |  |  |
| Cost of Sales | 325 | 510 |
| Office expenses | 20 | 25 |
| Selling expenses | 30 | 45 |
| Interest | 25 | 30 |
| Total expenses | 400 | 610 |
| Net profit | 120 | 105 |
| Grand Total | 520 | 715 |

PROBLEM-3

Prepare common size statement after finding GP, operating profit and profit after tax.

|  |  |  |
| --- | --- | --- |
|  | 2003(Rs.) | 2004(Rs.) |
| Revenue | 2,40,000 | 3,70,000 |
| Cost of goods sold | 94,000 | 1,22,000 |
| Productive wages | 44,000 | 71,000 |
| Operating expenses | 52,000 | 57,000 |
| Interest | 10,000 | 15,000 |
| Depreciation | 20,000 | 15,000 |
| Income tax rate | 30% | 30% |

PROBLEM-4

From the following information prepare a comparative income statement.

|  |  |  |
| --- | --- | --- |
|  | Year 2004 (Rs.) | Year 2005 (Rs.) |
| Sales | 4,00,000 | 5,00,000 |
| Cost of goods sold | 2,00,000 | 3,00,000 |
| Administrative and selling expenses | 40,000 | 1,00,000 |
| Other income | 20,000 | 30,000 |
| Income tax | 60,000 | 70,000 |

PROBLEM-5

The following Balance Sheet of a concern for the years 2009 and 2010. Prepare a comparative Balance Sheet and study the financial position of the concern

BALANCE SHEET AS ON 31.DEC.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Liabilities | 2009 | 2010 | Assets | 2009 | 2010 |
|  | Rs. | Rs. |  | Rs. | Rs. |
| Equity Share Capital | 6,00,000 | 8,00,000 | Land & Buildings | 3,70,000 | 2,70,000 |
| Reserve & Surplus | 3,30,000 | 2,22,000 | Plant & Machinery | 4,00,000 | 6,00,000 |
| Debentures | 2,00,000 | 3,00,000 | Furniture & Fixtures | 20,000 | 25,000 |
| Long term loans on Mortgages | 1,50,000 | 2,00,000 | Others Fixed Assets | 24,000 | 30,000 |
| Bills Payable | 50,000 | 45,000 | Cash in Hand and at bank | 20,000 | 80,000 |
| Sundry Creditors | 1,00,000 | 1,20,000 | Bills Receivables | 1,50,000 | 90,000 |
| Other Current liabilities | 5,000 | 10,000 | Sundry Debtors | 2,00,000 | 2,50,000 |
|  |  |  | Stock | 2,50,000 | 3,50,000 |
|  |  |  | Prepaid Expenses | 1,000 | 2,000 |
| Total | 14,35,000 | 16,97,000 |  | 14,35,000 | 16,97,000 |

PROBLEM-6

The Income statements of a concern are given for the years ending on 31st  Dec., 2009 and 2010, Re-arrange the figures in a comparative form and study the profitability position of the concern

|  |  |  |
| --- | --- | --- |
|  | 2009  Rs.(000) | 2010  Rs.(000) |
| Net sales | 785 | 900 |
| Cost of goods sold | 450 | 500 |
| Operating expenses:- |  |  |
| General and administrative expenses | 70 | 72 |
| Selling Expenses | 80 | 90 |
| Non-operating expenses:- |  |  |
| Interest paid | 25 | 30 |
| Income -Tax | 50 | 80 |

PROBLEM-7

From the following Profit and Loss Account and the Balance Sheet of Swadeshi Polytex Ltd. For the year ended 31st December, 1997 and 1998, you are required to prepare a common size Income Statement and a Balance Sheet.

Profit and Loss Account

(in Lakhs of Rs.)

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Expenses | 1997 | 1998 | Income | 1997 | 1998 |
| To Cost of Goods sold | 600 | 750 | By Net Sales | 800 | 1,000 |
| Operating Expenses Administration Expenses | 20 | 20 |  |  |  |
| Selling Expenses | 30 | 40 |  |  |  |
| Net Profit | 150 | 190 |  |  |  |
| Total | 800 | 1,000 |  | 800 | 1,000 |

BALANCE SHEET AS ON 31ST  DECEMBER

(in Lakhs of Rs.)

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Liabilities | 1997 | 1998 | Assets | 1997 | 1998 |
| Bills Payable | 50 | 75 | Cash | 100 | 140 |
| Sundry Creditors | 150 | 200 | Debtors | 200 | 300 |
| Tax Payable | 100 | 150 | Stock | 200 | 300 |
| 6% Debentures | 100 | 150 | Land | 100 | 100 |
| 6% Preference Capital | 300 | 300 | Building | 300 | 270 |
| Equity Capital | 400 | 400 | Plant | 100 | 270 |
| Reserve | 200 | 245 | Furniture | 1,300 | 140 |
| TOTAL | 1,300 | 1,520 | TOTAL | 1,300 | 1,520 |

PROBLEM-8

From the following Profit and Loss Account and the Balance Sheet of Swadeshi Polytex Ltd. For the year ended 31st December, 1997 and 1998, you are required to prepare a comparative Income Statement and a Comparative Balance Sheet.

Profit and Loss Account

(in Lakhs of Rs.)

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Expenses | 1997 | 1998 | Income | 1997 | 1998 |
| To Cost of Goods sold | 600 | 750 | By Net Sales | 800 | 1,000 |
| Operating Expenses Administration Expenses | 20 | 20 |  |  |  |
| Selling Expenses | 30 | 40 |  |  |  |
| Net Profit | 150 | 190 |  |  |  |
| Total | 800 | 1,000 |  | 800 | 1,000 |

BALANCE SHEET AS ON 31ST DECEMBER

(in Lakhs of Rs.)

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Liabilities | 1997 | 1998 | Assets | 1997 | 1998 |
| Bills Payable | 50 | 75 | Cash | 100 | 140 |
| Sundry Creditors | 150 | 200 | Debtors | 200 | 300 |
| Tax Payable | 100 | 150 | Stock | 200 | 300 |
| 6% Debentures | 100 | 150 | Land | 100 | 100 |
| 6%Preference Capital | 300 | 300 | Building | 300 | 270 |
| Equity Capital | 400 | 400 | Plant | 100 | 270 |
| Reserve | 200 | 245 | Furniture | 1,300 | 140 |
| TOTAL | 1,300 | 1,520 | TOTAL | 1,300 | 1,520 |

PROBLEM-9

From the following information, prepare a comparative income statement.

|  |  |  |
| --- | --- | --- |
|  | Year 2008  (Rs.) | Year 2009  (Rs.) |
| Sales | 1,00,000 | 1,50,000 |
| Cost of goods sold | 50,000 | 60,000 |
| Income Tax | 16,000 | 24,000 |
| Indirect expenses | 10,000 | 30,000 |

PROBLEM-10

Raman restaurant furnishes the following Profit and Loss account for the years 2001 and 2002. Prepare common size income statement for 2 years:-

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Particulars | 2001  (Rs.) | 2002  (Rs.) | Particulars | 2001  (Rs.) | 2002  (Rs.) |
| To. Cost of sales | 24,000 | 35,000 | By. Sales | 40,000 | 50,000 |
| Gross Profit | 16,000 | 15,000 |  |  |  |
|  | 40,000 | 50,000 |  | 40,000 | 50,000 |
| To. Operating Expenses:- |  |  | By.GP | 16,000 | 15,000 |
| Administration | 2,500 | 3,000 | Non- operating income | 2,000 | 5,000 |
| Selling | 1,500 | 2,000 |  |  |  |
| Distribution | 1,000 | 1,000 |  |  |  |
| Non-Operating Interest | 2,000 | 2,000 |  |  |  |
| Goodwill written off | 1,000 | ----------- |  |  |  |
| Net Profit | 10,000 | 12,000 |  |  |  |
|  | 18,000 | 20,000 |  | 18,000 | 20,000 |

TOPIC 3

**RATIO ANALYSIS**

Introduction

Financial statements are prepared primarily for decision making. They play a dominant role in setting the framework of managerial decisions. But the information provided in the financial statements is not an end in itself as no meaningful conclusions can be drawn from these statements alone. However, the information provided in the financial statements is of immense use in making decisions through analysis and interpretation of financial statements. Financial analysis and is the process of identifying the financial strengths and weaknesses of the firm by properly establishing relationship between the items of the balance sheet and the profit and loss account. There are various methods or techniques used in analysing financial statements, such as comparative statements, schedule of change in working capital, common size percentages, funds analysis; trend analysis and ratio analysis. The ration analysis is the most powerful tool of financial analysis.

Meaning of ‘Ratio’

A ratio is a simple arithmetical expression of the relationship of one number to another. It may be defined as the indicated quotient of two mathematical expressions. In simple language ratio is one number expressed it terms of another and can be worked out by dividing one number into the other. For example, if the current assents of a firm on a given date are Rs. 5,00,000 and the current liabilities are Rs. 2,50,000 then the ratio of current assets to current liabilities will work out to be 2,50,000 or 2. Such type of rations are called simple or pure ratios. A financial ratio is the relationship between two accounting figures expressed mathematically. A ratio can also be expressed as percentage by simply multiplying the ratio by 100. As in the above example, the ratio is 2x100 or 200% or say current assets are 200% of current liabilities. It is also expressed as a proportion, for example ratio of current assets to current liabilities is say, 5,00,000:2,50,000 or 2:1. Some analysts also express ratio as a ‘rate’ or ‘time’. For example the ratio of stock

turnover is, say 50000/10,000 or a 5 times which simply conveys that stock has been turned over 5 times. In the example given above current assets Rs. 5,00,000 and current liabilities Rs. 2,50,000 we can say that the ratio is 2 rimes.

Meaning and Nature of Ratio Analysis

Ratio analysis is a technique of analysis and interpretation of financial statements. It is the process of establishing and interpreting various ratios for helping in making certain decisions. It involves four steps:

Selection of relevant data from the financial statements depending upon the objective of the analysis.

Calculation of appropriate ratios from the above data.

Comparison of the calculated ratios with the ratios of the same firm to the past, or the ratios, developed from projected financial statements or the ratios of some other firms or the comparison with the ratios of the industry to which the firm belongs.

Interpretation of the ratios.

Classification of Ratios

The use of ratio analysis is not confined to financial manager only. There are different parties interested in the ratio analysis for knowing the financial position of a firm for different purposes In view of various users of ratios, there are many types of ratios which can be calculated from the information given in the financial statements. The particular purpose of the user determines the particular ratios that might be used for financial analysis. For example, a supplier of goods to a firm on credit or a banker advancing a short term loan to a firm is interest primarily in the short term paying capacity of the firm or say it’s liquidity. On the other hand, a financial institution advancing long term credit to a firm will be primarily interested in the solvency or long term financial position of the concern. Similarly, the interests of the owners (shareholders) and the management also differ. The shareholders are generally interested in the profitability or dividend position of a firm while management requires information on almost all the financial aspects of the firm to enable it to protect the interests of all the parties.

The various accounting ratios can be classified as follows:

Ratios

1. (B) (C)

Traditional Classification Functional Classification Significance Ratios

Or Or Or

Statement Ratios Classification According to Tests Ratios According to

Importance

1. Balance sheet Ratios 1.Liquidity Ratios

Or 2.Leverage Ratios 1. Primary Rations

Position Statement Ratios 3.Activity Ratios 2.Secondary Ratios

4.Profitability Ratios

2. Profit and Loss Account Ratios

Or

Revenue/Income Statement Rations

3. Composite/Mixed Rations

Or

Inter-Statement rations

**(A)** **Traditional Classification or Statement Ratios**

Traditional classification or classification according to the statement, from which these rations are calculated is as follows:

Traditional Classification or Statement Rations

Balance Sheet Ratios Profit and Loss Account Rations Composite/mixed Ratio

Or Or Or

Position Statement Rations Revenue/Income Statement Ratios Inter-Statement Ratios

1.Current Ratio 1.Gross Profit Ratio 1.Stock Turnover Ratio

2.Liquid(Acid Test or Quick Ratio) 2.Operating Ratio 2.Debtors Turnover ratio

3.Absolute Liquidity Ratio 3.Operating Profit Ratio 3.Payable Turnover Ratio

4.Debt Equity Ratio 4.Net Profit Ratio 4.Fixed Assets Turnover

5.Proprietory Ratio 5.Expense ratio Ratio

6.Capital Gearing Ratio 6.Interest coverage ratio 5.Return equity capital

6.Return on Shareholders

7.Assets-proprietorship ratio funds

8.inventory to working capital ratio 7.Return on Capital

9.Ratio of current assets to fixed assets Employed

8.Capital turnover ratio

9.Working capital turn

Over ratio

10.Return on total

Resources

11.Total Assets Turnover

**(a)Balance Sheet or Position Statement Ratios**:- Balance sheet ratios deal with the relationship between two balance sheet items, e g. The ratio of current assets to current liabilities, or the ratio of proprietors funds to fixed assets. Both the items must, however, pertain to the same balance sheet. The various balance sheet ratios have been named in the chard classifying statement ratios.

(**b)profit and loss Account or Revenue/Income Statement Ratios:-** These ratios deal with the relationship between two profit and loss account items, e.g., the ratio of gross profit to sales, or the ratio of net profit to sales. Both the items must, however , belong to the same profit and loss account. The various profit and loss account rations, commonly used, are named in the chart classifying statement ratios.

**(c)Composite/mixed Ratios or Inter statement Ratios:-** These ratios exhibit the relation between a profit and loss account or income statement item and a balance sheet item, e.g., stock turnover ratio, or the ratio of total assets to sales. The most commonly used inter statement ratios are given in the chart exhibiting traditional classification or statement ratios.

**(B)Functional Classification or Classification according to Tests:-** In view of the financial management or according to the tests satisfied, various rations have been classified on the next page.

**(a)Liquidity Ratios:-** These are the ratios which measure the short term solvency or financial position of a firm. These ratios are calculated to comment upon the short term paying capacity of a concern or the firm’s ability to meet its current obligations. The various liquidity ratios and absolute liquidity ratios are current ratio, liquid ratios and absolute liquid ratio. Further to see the efficiency with which the liquid resources have been employed by a firm, debtors turn over and creditors turnover ratios are calculated.

**(b)Long term Solvency and Leverage Rations:-** Long term solvency rations convey a firm’s ability to meet the interest costs and repayment schedules of its long term obligations, e.g.. Debt Equity Ratio and Interest Coverage Ration. Leverage Rations show the proportions of debt and equity in financing of the firm. These ratios measure the contribution of financing by owners as compared to financing by outsiders. The leverage ratios can further

Declassified as: (i) Financial Leverage (ii) Operating Leverage (iii) Composite Leverage.

(c) ***Activity Ratios:-*** Activity ratios are ejaculated to measure the efficiency with which the resources of a firm have been employed. These ratios are also called turnover ratios because they indicate the speed with which assets are being turned over into sales, e.g.. debtors turnover ratio or stock turnover ratio. The various activity or turnover ratios been named in the chart classifying the ratios.

.

Functional Classification in View of Financial Management or Classification According to Tests

Liquidity Ratios Long term solvency and Activity Ratios Profitability Ratios

Leverage Ratios

(A) 1. Current Ratios

2.Liquid (Acid Financial Operating Composite 1. Inventory turnover ratio (a) In realation

test or quick ratio) 2.Debtors turnover ratio to sales

3.Fixed Assets 1.Gross profit

3. Absolute liquid ratio 4.total assets turnover ratio rato

1.Debto-Equity ratio 5.Working Capital 2.Operating

(B) 1. Debtors Turn 2.Debt to total capital ratio turnover ratio ratio

over ratio 3.Interet coverage ratio 6.Payables turnover ratio 3.Operating

4.Cash flow Debt service 7.Capital employed ratio

ratio turnover ratio 4.Net profit

2. Creditors Turn 5.Capital gearing ratio

Over ratio (b) In relation

to investments

3. Inventory turn 6.Return on

over ratio investments

7.Return on

Capital

8.Return on

Equity capital

9.Return on

Total

Resources

10. Earnings

Per share

11.Price –

earning Ratio

**(d)Profitability Ratios:-**These ratios measure the results of business operations or overall performance and effectiveness of the firm, e.g., gross profit ratio, operating ratio or return on capital employed. The various profitability ratios have been given in the chart exhibiting the classification of ratios according to tests. Generally, two types of profitability ratios are calculated (i) in relation of sales and (ii) in relation to investments.

**(c) Classification According to Significance or Importance**

The ratios have also been classified according to their significance or importance. Some ratios are more important than others and the firm may classify them as primary and secondary ratios. The British Institute of Management has recommended the classification of ratio according to importance for inter firm comparisons. For inter firm comparisons, the ratios maybe classified as primary Ratio and Secondary Ratios. The primary ratio is one which is of prime importance to a concern, thus, return on capital employed is named as primary ratio are called secondary ratios e.g., the relationship of operating profit to sales or the relationship of sales to total assets of firm.

**DU PONT CONTROL CHART**

Return on investment (ROI) represents the earning power of the company. ROI depends on two ratio: (a) Net Profit Ratio and (b) Capital Turnover Ratio. A change in any of these will change the farm’s earning power. These two ratios are affected by many factors. A change in any way of these factors will change these ratios also. The various factors affecting the ROI can be put through a chart given below. This chart is know as the Due Point Control chart since it was first used by Du Point company in the USA.

Return on Capital Invested(ROI)

Net Profit Ratio

Net Profit

Sales

Capital Turnover

Sales

Capital Employed

Fixed Assets

Working Capital

Current Assets

Current Liabilities

Cost of Goods Sold

Admn., Selling and Distribution Expenses

Sale

\_

÷ +

Expenses

x

+ \_

**÷** +

The chart show that return on capital employed is affected by a number of factors. Any change in these factors will affect the return on capital employed. For example, if the cost of goods sold increase, without any corresponding increase in the selling price of the goods sold increases, without any corresponding increase in the selling price of the goods, the net profit would decrease and consequently ROI would also decrease. Similarly, if there is, increase in working capital, the total capital employed would increase and therefore, in the absence of any increase in the net profit. ROI would decrease.

The chart helps the management in concentrating attention on different forces affecting net profit. An increasing in profit can be achieved either by more effective use of capital which will result in a higher turnover ratio or better sales efforts which will Result in a higher net profit ratio. The same return can be obtained either by a low net profit ratio but a higher turnover ratio or a lower turnover ratio but a high net profit ratio.

**ADVANTAGES OF RATIO ANALYSIS**

**(1)Simplifies financial Statements:**

Ratio Analysis simplifies the comprehension of financial statements. Ratios tell the whole story of changes in the financial condition of the business.

**(2)Facilitates inter-firm comparison**

Ratio Analysis provides data for inter-firm comparison. Ratios highlight the factors associated with successful and unsuccessful firms. They also reveal strong firms and weak firms, over-valued and undervalued firms.

**(3)Makes intra-firm comparison possible**

Ratio analysis helps in planning and forecasting. Over a period of time a firm or industry develops certain norms that may indicate future success or failure. If relationship changes in firm’s data over different time periods, the ratios may provide clues on trends and future problems.

Thus, “ratios can assist management in its basic function of forecasting, planning, coordination, control and communication.”

**LIMITATIONS OF RATIO ANALYSIS**

The ratio analysis is one of the most powerful tools of financial management. Though ratios are simple to calculate and easy to understand, they suffer from some serious limitations:-

1. **Limited uses of a Single Ratio**

A single ratio, usually , does not convey much of a sense. To make a better interpretation, a number of ratios have to be calculated which is likely to confuse the analyst than help him in making any meaningful conclusion.

**2)** **Lack of Adequate Standards**

There are no well accepted standards or rules of thump for all rations which can be accepted as norms. It renders interpretation of the rations difficult.

**3)** **Inherent Limitations of Accounting**

Like financial statements, ratios also suffer from the inherent weakness of accounting records such as their historical nature. Ratios of the past are not necessarily true indicators of the future.

**4)** **Change in Accounting Procedure**.

Change in accounting procedure by a firm often makes ratio analysis misleading, e g:- a change in the valuation of methods of inventories, from FIFO to LIFO increases the cost of sales and reduces considerably the value of closing stocks which makes stock turnover ratio to be Iucrative and an unfavourable gross profit ratio.

**5)** **Window Dressing**

Financial statements can easily be window dressed to present a better picture of its financial and profitability position to outsiders. Hence, one has to be very careful in making a decision from ratios calculated from such financial statement. But it may be very difficult for an outsider to know about the window dressing make by a firm.

**6) Personal Bias**

Ratios are only means of financial analysis and not an end in itself. Ratios have to be interpreted and different people may interpret the same ratio in different ways.

**7)** **Un comparable**

Not only industries differ in their nature, but also the firms of the similar business widely differ in their size and accounting procedure, etc..It makes comparison of ratios difficult and misleading. Moreover, comparisons are

Made difficult due to differences in definitions of various financial terms used in the ratio analysis.

**8) Absolute figures Distortive**

Ratios devoid of absolute figures may prove distortive as ratio analysis is primarily a analysis and not a qualitative analysis

**9) Price Level Changes**

While making ratio analysis, no consideration is made to the changes in price levels and this makes the interpretation of ratios as invalid.

**10) Ratios no Substitutes**

Ratios analysis is merely a tool of financial statements. Hence, ratios become useless if separated from the statements from which they are computed.

**SUMMARY OF BASIC RATIOS AND THEIR PURPOSE**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Sl.No | Ratio | **Computation**  **Formula** | Purpose | Remarks |
| 1. | Gross profit  Ratio | Gross Profit  x100  Net Sale | Indicates the efficiency of  the production/  Trading  operation | GP=  Sales-CGS  Sales=  Total sales  It is  expressed  as % |
| 2. | Net Profit Ratio | Net Profit  x100  Net Sales | Indicates net margin on  sales | Do |
| 3. | Operating / Expenses Ratio | Operating Expense  x100  Net Sales | A measure of manager’s  ability to keep  Operating expenses  Properly  Controlled for level of sales  achieved | Do |
| 4. | Return on share holders funds/  Return on investment (Rol) | Net Profit  x100 Share holder’s funds | Measures  earning power  of equity  capital | Do |
| 5. | Inventory  turnover/ stock  turnover/ stock  velocity | Cost of Goods sold  Average Stock | Evaluation of  the liquidity of inventory and adequacy of inventory  controls | Expressed  in times |
|  | Average stock | Opening stock +  Closing stock  2 |  |  |
| 6 | Debtors  turnover/  accounts  receivable  turnover/  debtors velocity | Net credit sales  Debtors + BiIls  receivable | Measures  Liquidity of accounts receivables  and the  effectiveness  of credit  policy | Do. |
|  | Net credit sales  = | Total sales- cash  sales |  |  |
| 7 | Average  Collection period | 360  DTR OR  12  DTR  Or  52  DTR | Shows speed of debt collection. Lesser the  ratios better is financial  position | Expressed  in days  Expressed  in months  Expressed  in week |
| 8 | Creditors  turnover ratio/  Payables  turnover ratio | Net credit purchase  Creditors + Bills  payable | It indicates the  speed with  which the  payments for  creditpurchases are made to the  creditors. | Expressed  in time |
|  | Net credit  Purchase = | Total purchases –  Cash purchases |  |  |
| 9 | Average  Payment period | 360  CTR  OR  12  CTR  OR  52  CTR | It indicates the speed with  which the payments for credit  purchases are made to the creditors | Expressed  in no of  days  Expressed  in months  Expressed  in weeks |
| 10 | Current ratio | Current Assets  Current liabilities | Measures short  term debt  facility | Standard  ratio  2:1 |
| 11 | Quick/acid test / liquidity | Quick Asset  Quick Liabilities | A refined  measure of  short –term  debt paying  ability by measuring  short term  liquidity | Do  1 : 1 |
|  | QA= | CA-Stock-prepaid |  |  |
|  | QL= | QL= CL –Bank OD |  |  |
| 12 | Proprietary ratio | Total shareholders  funds  Total tangible  assets | Shows the  extent of shareholder’s funds in the  total assets employed in the business |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 13 | Debt equity ratio | External equities  Internal equities  OR  Outsiders fund  Shareholders funds | Indicates the percentage of funds being financed through borrowings; |  |
| 14 | Fixed assets  Turnover ratio | Net Sales  Fixed assets | It indicates the extent to which the investment in fixed assets contribute  towards sales | Expressed  in times |
| 15 | Working capital  Turnover ratio | Net sales  Working Capital | It indicates whether or not the working capital has been effectively utilized. | Do |
|  | Working capital= | CA-CL |  |  |

Shareholder’s funds= Equity shares + Preference shares + Nt Profit + General Reserve

Outsiders fund/ external equity = Debenture + Current liabilities

**ADVANCED PROBLEMS**

**PROBLEM-1**

|  |  |  |
| --- | --- | --- |
|  | 1997  Rs. | 1998  Rs. |
| Net Sales | 1,00,000 | 1,50,000 |
| Less cost of sales | 70,000 | 1,10,000 |
|  |  |  |
| Gross Profit | 30,000 | 40,000 |
| Less Operating expenses | 20,000 | 25,000 |
|  |  |  |
| Net Profit | 10,000 | 15,000 |
|  |  |  |
| Cash in Hand | 5,000 | 8,000 |
| Cash at Bank | 4,000 | 2,000 |
| Debtors | 40,000 | 25,000 |
| Stock at cost | 15,000 | 10,000 |
| Fixed Assets(Net) | 56,000 | 65,000 |
|  |  |  |
|  | **1,20,000** | **1,10,000** |
| Creditors | 36,000 | 12,000 |
| Bills payable | 2,000 | 1,000 |
| Mortgage loan | 10,000 | 20,000 |
| Equity share capital | 60,000 | 70,000 |
| Reserve & Surplus | 12,000 | 7,000 |
|  | **1,20,000** | **1,10,000** |

You are required to calcutate the following ratios for both the years

1. Current Ratio
2. Acid Test Ratio
3. Debtors Turnover Radio
4. Average collection Period
5. Stock Turnover Ratio

(Assume 360 days in a year)

**PROBLEM-2**

From the following financial statement calcutate:-

(a)Gross Profit Ratio

(b)net Profit Ratio

(c)Stock turnover ratio

**Trading and Profit & Loss Account**

|  |  |  |  |
| --- | --- | --- | --- |
| Particulars | Amount  (Rs.) | Particulars | Amount  (Rs.) |
| To Opening stock | 10,000 | By sales | 50,000 |
| To Purchases | 20,000 | By Closing Stock | 12,000 |
| To Gross Profit c/d | 32,000 |  |  |
|  | 62,000 |  | 62,000 |
|  |  | By Gross Profit b/d | 32,000 |
| To expenses | 22,000 |  |  |
| To Net net Profit | 10,000 |  |  |
| **Total** | **32,000** |  | **32,000** |

**(TEE 2007)**

**PROBLEM-3**

The following are the summarized Profit Loss Account of Hind products Ltd for the year ending 31st December, 1994 and Balance Sheet as on that date

**PROFIT & LOSS ACCOUNT**

|  |  |  |  |
| --- | --- | --- | --- |
| Dr | Rs |  | Rs |
| To Opening Stock | 99,500 | By sales(cash & credits) | 8,50,000 |
| To Purchases | 5,45,250 | By Closing stock | 1,49,000 |
| To incidental expenses | 14,250 |  |  |
| To gross profit | 3,40,000 |  |  |
|  | 9,99,000  ======= |  | 9,99,000  ======= |
| To operating expenses |  | By Gross profit | 3,40,000 |
| Selling & distribution  30,000  Administration 1,50,000  Finance 15,000 |  | By non operating income:-  Interest 3,000  Profit on  Sales of shares 6,000 |  |
|  | 1,95,000 |  | 9,000 |
| To non operating expenses |  |  |  |
| Loss on sales of assets | 4,000 |  |  |
| To net profit | 1,50,000 |  |  |
|  | 3,49,000 |  | 3,49,000 |

**BALANCE SHEET**

|  |  |  |  |
| --- | --- | --- | --- |
| Liabilities | Rs. | Assets | Rs. |
| Issued Capital 2000 Equity shares of Rs. 100each | 2,00,000 | Land and Building | 1,50,000 |
| Reserves | 90,000 | Plant & machinery | 80,000 |
| Current Liabilities | 90,000 | Stock in trade | 1,49,000 |
| Profit & Loss account | 60,000 | Sundry Debtors | 41,000 |
| Bills payable | 40,000 | Cash & Bank balance | 30,000 |
|  |  | Bills receivable | 30,000 |
|  | 4,80,000 |  | 4,80,000 |

From the above statements, you are required to calculate the following ratios:

1.Current ratio 6.Return on total resources

2.Acid text ratio 7.Return on proprietors funds

3.Stock turnover ratio 8.Gross profit ratio

4.Operating ratio 9.Net Profit ratio

5.Operating profit ratio 10.Debt Equity ratio **(TEE 1995)**

**PROBLEM-4**

Following are the Trading and Profit and Loss Account, of Sun Ltd. For this year ending 31st December, 1996 and the Balance Sheet as on that date:

|  |  |  |  |
| --- | --- | --- | --- |
|  | Rs |  | Rs. |
| To opening stock | 1,45,000 | By sales | 7,50,000 |
| To Purchases | 6,10,000 | By Closing stock | 1,55,000 |
| To gross profit | 1,50,000 |  |  |
|  | 9,05,000  ======= |  | 9,05,000  ======= |
| To sundry expenses | 80,000 | By gross profit | 1,50,000 |
| To net profit | 70,000 |  |  |
|  | 1,50,000  ======= |  | 1,50,000  ======= |

**Balance sheet as on 31st December, 1996**

|  |  |  |  |
| --- | --- | --- | --- |
|  | Rs. |  | Rs. |
| Share capital | 7,00,000 | Next fixed assets | 5,50,000 |
| Reserves and surplus  Balance 50,000  Profit for 96 70,000 | 1,20,000 | Current assets: |  |
| Bank overdraft | 35,000 | Stock | 1,55,000 |
| Creditors | 1,50,000 | Debtors | 80,000 |
|  |  | Cash | 2,20,000 |
|  | 10,05,000 |  | 10,05,000 |

Your are required to calculate the following rations:-

1. Current ratio
2. Quick Ratio
3. Stock turnover ratio
4. Debtors turnover ratio
5. Return on owners equity

**(TEE 19**

The balance sheet and condensed income statement are below.

**PROBLEM - 5**

Duke Synder Motel

**Balance Sheet**

**December 31, 1996**

|  |  |
| --- | --- |
| Assets | **Rs.** |
| Current Assets. |  |
| Cash | 95,000 |
| Accounts receivable | 1,00,000 |
| Iventories | 5,000 |
| Total Current Assets | **2,00,000** |
|  |  |
| Property and equipment: |  |
| Land | 60,000 |
| Building (net) | 3,00,000 |
| Furniture & Equipment net | 80,000 |
| Total property & equipment | **4,40,000** |
| Total Assets | **6,40,000** |
| **Liabilities and Owner’s equity** |  |
| Current Liabilities | 2,10,000 |
| Long term liabilities |  |
| Note from owner | 40,000 |
| Mortgage payable | 80,000 |
| **Total Liabilities** | **3,30,000** |
| Owner’s equity: |  |
| Common stock | 1,00,000 |
| Retained earnings | 2,10,000 |
| **Total Owner’s equity** | **3,10,000** |
| **Total Liabilities and owner’s equity** | **6,40,000** |
| Duke snyder motel  **Condensed income statement**  for the year ended December 31, 1996 |  |
| Sales | 15,00,000 |
| Cost of goods sold | 2,00,000 |
| Operating expenses | 8,00,00 |
| Contribution margin | 5,00,000 |
| Undistributed operating expenses | 1,25,000 |
|  |  |
| **Income before fixed charges** | **3,75,000** |
| Interest | 1,20,000 |
| Other fixed charges | 1,62,000 |
| Income before taxes | 93,000 |
| Income tax | 27,000 |
| **Net income** | **65,100** |

From the above mentioned information, calculate the following ratios:

1. Current ration
2. Acid test ratio
3. Debt equity ratio
4. Net profit ratio
5. Return on total assets

**PROBLEM - 6**

The following are the figures extracted from the books of XYZ Ltd, as at

30.06.1998 Particulars

|  |  |
| --- | --- |
|  | **Rs.** |
| Net sales | 24,00,000 |
| Less operating expense | 18,00,000 |
| **Gross Profit** | **6,00,000** |
| Less Operating expense | 2,40,000 |
| **Net Profit** | **3,60,000** |
| Current Assets | 7,60,000 |
| Inventories | 8,00,000 |
| Fixed assets | 14,40,000 |
| **Total Assets** | **30,00,000** |
| Net worth | 15,00,000 |
| Debt | 9,00,000 |
| Current liabilities | 6,00,000 |
| Total liabilities | **30,00,000** |
| Working Capital | 9,60,000 |
| Calculate :- |
| 1. Gross profit ratio |
| 1. Net profit ratio |
| 1. Return on assets |
| 1. Inventory turnover |
| 1. Working capital turnover |
| 1. Net worth to debt |

**PROBLEM - 7**

The following is the Balance Sheet of Golden Hotel Limited as on December 31, 1989

|  |  |  |  |
| --- | --- | --- | --- |
| Liabilities | Rs. |  | Rs. |
| Equity share capital | 1,00,000 | Fixed Assets 3,60,000 |  |
|  |  | Less Depreciation 1,00,000 | 2,60,000 |
| 7% preference share  capital | 20,000 | **Current Assets :-** |  |
| Reserves & Surplus | 80,000 | Cash | 10,000 |
| 7% mortgage debenture | 1,40,000 | Investments (Govt. Securities 10% interest | 30,000 |
| **Current Liabilities :-** |  |  |  |
| Creditors | 12,000 | Sundry debtors | 40,000 |
| Bills payable - | 20,000 | Stock | 60,000 |
| Outstanding expenses | 2,000 |  |  |
| Taxation provision | 26,000 |  |  |
|  | 4,00,000 |  | 4,00,000 |

Other information

|  |  |
| --- | --- |
|  | Rs. |
| Net sales | 6,00,000 |
| Cost of goods sold | 5,16,000 |
| Net income before tax | 40,000 |
| Net income after tax | 20,000 |
|  |  |
| Calculate the following ratios from the given information:- |  |
|  |  |
| 1. Current ratio |  |
| 1. Acid test ratio |  |
| 1. Debt. Equity ratio |  |
| 1. Proprietary ratio |  |
| 1. Gross profit ratio |  |
| 1. Net profit ratio |  |

**(TEE 1991)**

**PROBLEM - 8**

From the following compute the following ratios:

1. Gross profit ratio 2) Current Ratio 3) Liquidity ratio

|  |  |
| --- | --- |
|  | Rs. |
| Sales | 3,00,000 |
| Cost of sales | 2,50,000 |
| Administration expenses | 40,000 |
| Office expenses | 25,000 |
| Selling & distribution expenses | 10,000 |
| Land & building | 4,00,000 |
| Cash in hand | 55,000 |
| Cash at bank | 67,000 |
| Stock | 9,000 |
| Prepaid expenses | 22,000 |
| Marketable securities | 5,000 |
| Bank overdraft | 40,000 |
| Sundry creditors | 70,000 |
| Bills payable | 40,000 |

**(TEE, 1999)**

**PROBLEM - 9**

The following are the Final A/C of XYZ Restaurant for the year 1999 and 1998.

|  |  |  |
| --- | --- | --- |
| Particulars | Amount (1999)  ( Rs.) | Amount (1998)  (Rs.) |
| Cash balance | 6,000 | 8,000 |
| A/C receivables | 16,000 | 14,000 |
| Inventory | 32,000 | 28,000 |
| Buildings & Furniture | 1,86,000 | 1,80,000 |
| **Total Assets** | **2,40,000** | **2,30,000** |
| Current Laibilities | 20,000 | 15,000 |
| Mortgage Liabilities | 80,000 | 85,000 |
| Common stock (Rs. 10/- pershare) | 1,00,000 | 1,00,000 |
| Retained earnings | 40,000 | 30,000 |
|  | **2,40,000** | **2,30,000** |

**COMPARATIVE INCOME STATEMENT**

|  |  |  |
| --- | --- | --- |
| Particulars | Amount(1999) | Amount(1998) |
| Revenue | 2,00,000 | 1,80,000 |
| Cost of goods sold | 1,20,000 | 1,09,000 |
| Gross profit | 80,000 | 71,000 |
| Operating expenses | 49,000 | 45,000 |
| Operating income | 31,000 | 26,000 |
| Interest expenses:- | 5,000 | 5,500 |
| Income before I.T | 26,000 | 20,500 |
| I.T. | 6,000 | 5,500 |
| Net income | 20,000 | 15,000 |

Calculate the rtio for 1999 and 1998

1.Current ratio

2.Acid test ratio

3.Average collection perios

4.Return of assets

5.Return of owner’s equity

**PROBLEM-10**

Calculate the following ratios from the Balance sheet given hereunder:

1. Current Ratio (b)Stock turnver ratio
2. Return on Capital Employed (e) Fixed Assets turnover ratio

**BALANCE SHEET**

|  |  |  |  |
| --- | --- | --- | --- |
|  | Amount  In Rs. |  | Amount  in Rs. |
| Shares | 2,00,000 | Fixed Assets | 2,30,000 |
| Reserves and Surplus | 80,000 | Current Assets (Stock /rs. 80,000) | 2,40,000 |
| Long term loan | 70,000 |  |  |
| Current liabilities | 1,20,000 |  |  |
| **Total** | **4,70,000** |  | **4,70,000** |

Assume Sales Rs.8,00,000/- and profit for the year Rs. 60,000/-

**(TEE – 2008)**

**PROBLEM-11**

From the following financial statement, calculate

1. Current Asset Ratio
2. Stock Turnover Ratio
3. Gross Profit Ratio
4. Net Profit Ratio
5. Liquidity Ratio

**Trading and Profit & Loss Account**

|  |  |  |  |
| --- | --- | --- | --- |
|  | Rs. |  | Rs. |
| To Opening Stock | 1,000 | By sales | 8,000 |
| To Purchase | 4,000 | By Closing Stock | 2,000 |
| To Gross Profit C/d | 5,000 |  |  |
|  | **10,000** |  | **10,000** |
| To sundry Expenses | 4,000 | By Gross Profit b/d | 5,000 |
| To Net Profit | 1,000 |  |  |
|  | 5,000 |  | 5,000 |

**Balance Sheet**

|  |  |  |  |
| --- | --- | --- | --- |
| Liabilities | Rs. | Assets | Rs. |
| Capital 22,000  Add Net Profit 1,000 | 23,000 | Fixed Assets | 20,000 |
| Current Liabilities | 3,000/- | Current Assets:  Liquid Assets -4,000  Stock -2,000 | 6,000 |
|  | **26,000** |  | **26,000** |

**(TEE-2001)**

**PROBLEM - 12**

Given below are the Balance sheet and income statement of Hotel River side

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Liabilities | Rs. | Assets | Rs. | Rs. |
| Share capital | 15.00 | Fixed Assets | 59.00 |  |
| Reserves & Surplus | 11.20 | Gross Block | 26.00 |  |
| Long Term Loans | 21.20 | Accured Depreciation |  | 33.00 |
| Current Liabilities and provisions | 10.50 | Investment |  | 1.00 |
|  |  | Current Assets |  |  |
|  |  | Cash & Bank | 0.20 |  |
|  |  | Debtors | 11.80 |  |
|  |  | Stock | 10.60 |  |
|  |  | Prepaid expenses | 0.80 | 23.40 |
|  |  | Other expenses |  | 0.50 |
|  | **57.90** |  |  | **57.90** |

Income Statement for the year ended December 31, 2000

(Rupees in Lakhs)

Rs.

|  |  |  |
| --- | --- | --- |
| Net Sales |  | 70.10 |
| Less: Cost of goods sold |  | 55.20 |
| Gross Profit |  | 14.90 |
| Less: Operating expenses |  |  |
| General Administration | 1.20 |  |
| Selling | 1.40 |  |
| Depreciation | 3.00 | 5.60 |
| Operating profit |  | 9.30 |
| Less:Non Operaing expenses |  | 0.40 |
| Profit before Interest and Tax |  | 8.90 |
| Less:Interest |  | 2.10 |
| Profit before tax |  | 6.80 |
| Less:Tax |  | 3.50 |
| Profit after Tax |  | 3.30 |

Calculate the following ratios:

a)Current Ratio f)Total Assets-Turnover Ratio

b)Acid Test Ratio g)Gross Profit Ratio

c)Debt Equity Ratio h) Rate of Return on Investment

d)Debt-Assets Ratio **(TEE 2002)**

e)Inventory Turnover Ratio

T6UYUTTTYTYHY

**PROBLEM- 13**

The following resuts relate to a catering company for the year ended 31st  March 2001.

**TRADING & PROFIT &LOSS ACCOUNT**

|  |  |  |  |
| --- | --- | --- | --- |
| Particulars | Rs. | Particulars | Rs. |
| To Opening stock  To cash purchases 4,500  To Credit purchases 7,700  To gross profit c/d | 800  12,200  23,700 | By sales 13,500  By Cash sales 21,000  By Closing stock | 34,500  2,200 |
| To sundry expenses | **36,700** |  | **36,700** |
| To Net profit c/o | 11,200 | By Gross profit b/d | 23,700 |
|  | 12,500 |  |  |
|  | **23,700** |  | **23,700** |

**BALANCE SHEET**

|  |  |  |  |
| --- | --- | --- | --- |
| Liabilities | Rs. | Assets | Rs. |
| Capital 20,000  Add:Net Profit 12,500 | 32,500 | Lease-held premises  Plant and Machinery | 15,000  10,500 |
| **Current Liabilities**  Sundry Creditors 4,500  Other Outstanding 2,500 | 7,000 | **Current Assets**  Sundry Debtors 8,525  Cash & Bank 4,000  Stock 1,475 |  |
|  | **39,500** |  | **39,500** |

Calculate the ratios from the above for the year 2001 2001. Ratios for the year 2000 are given below.

**Result for the year 2000 2001**

1. Current Ratio 2.1:1
2. Liquidity Ratio 1.5:1
3. Stock tunover ratio 12 times
4. Debtors turnover ratio 8 times
5. Creditors turnover ratio 6 times
6. Return on investment 36%
7. Gross profit ratio 60%
8. Net profit ratio 40%

Comment on the deviations if any between the results of the year 2000 and 2001

**PROBLEM-14**

**(Hotel Green Park)**

**Balance Sheet as at 31.12.2004**

|  |  |  |  |
| --- | --- | --- | --- |
| **LIABILITIES** | **Rs.** | **ASSETS** | **Rs.** |
| Notes and Accounts | 2,50,000 | Cash | 20,833 |
| Payable |  |  |  |
| Retained Earnings | 3,00,000 | Debtors | 1,66,667 |
| Share Capital | 2,00,000 | Inventor | 3,50,000 |
|  |  | Plant & Equipment | 2,12,500 |
| **TOTAL** | **7,50,000** |  | **7,50,000** |

Assuming the sales for the year was Rs. 15,00,000/- calculate the following rarios with the help of the Balance Sheet information given above:

1. Debt – Equity Ratio
2. Total Assets Turnover Ratio
3. Debtors Turnover Ratio
4. Acid Test Ratio
5. Current Ratio

**(TEE 2009)**

**PROBLEM-15**

Compute the following ratios from the given data.

1. Gross profit ratio
2. Current Ratio
3. Liquidity ratio
4. Stock turnove ratio

|  |  |  |  |
| --- | --- | --- | --- |
|  | Rs. |  | Rs. |
| Sales | 6,00,000 | Cash at Bank | 1,34,000 |
| Cost of sales | 5,00,000 | Stock | 18,000 |
| Administration expenses | 80,000 | Prepaid expenses | 44,000 |
| Office expenses | 50,000 | Mardetable securities | 10,000 |
| Selling and Distribution expenses | 20,000 | Bank overdraft | 80,000 |
| Land and Building | 8,00,000 | Sundry Creditors | 1,40,000 |
| Cash in hand | 1,10,000 | Bills payable | 80,000 |

**(TEE 2005)**

**PROBLEM-16**

Balance Sheet

|  |  |  |  |
| --- | --- | --- | --- |
| **LIABILITIES** | **Rs.** | **ASSETS** | **Rs.** |
| Equity shares of Rs.10/- each | 1,00,000 | Fixed Assets(at cost) | 1,40,000 |
| Reserves | 20,000 | Stock | 30,000 |
| Profit & Loss Account | 30,000 | Debtors | 30,000 |
| Secured Loan | 80,000 | Advances. | 10,000 |
| Creditors | 50,000 | Cash in hand | 30,000 |
| Provisions for taxation | 20,000 | Other Asset (Goodwill) | 60,000 |
|  | **3,00,00** |  | **3,00,000** |

(Note: The Sales for the year was Rs. 5,60,000/-)

Calculate the following ratios:

1. Debt-Equity Ratio
2. Liquidity Ratio
3. Fixed Assets tp Current Assets Ratio
4. Current Ratio

**(TEE 2006, 2008 & 2009)**

**PROBLEM-17**

From the following summarized balance sheet and profit and loss account of a

hotel, compute:-

1. Current ratio b) Debt-equity ratio c) Stock- turnover ratio d) NP ratio

e) Debtors collectio period (in weeks)

**BALANCE SHEET**

|  |  |  |  |
| --- | --- | --- | --- |
| Liabilities | Amount  (Rs.) | Assets | Amount  (Rs.) |
| Issued capital | 4,00,000 | Land and Buildings | 3,00,000 |
| Reserves and surplus | 240,000 | Plant and machinery | 160,000 |
| Creditors | 2,00,000 | Stock | 298,000 |
| P&L account | 60,000 | Debtors | 140,000 |
| 6% Debentures | 60,000 | Cash and Bank balance | 62,000 |
| TOTAL | 960,000 | TOTAL | 960,000 |

**PROFIT AND LOSS ACCOUNT**

|  |  |  |  |
| --- | --- | --- | --- |
| To. Opening  Stock | 199,000 | By. Sales | 17,00,000 |
| Purchase | 10,90,500 | Closing  Stock | 298,000 |
| Direct Expenses | 28,500 |  |  |
| Gross Profit | 680,000 |  |  |
|  | **19,98,000** |  | **19,98,000** |
| To.  Administrative  expenses | 3,00,000 | By Gross Profit  B/d | 6,80,000 |
| Selling and Dis. Expenses | 60,000 | By Non operating income | 18,0000 |
| To Incidental expenses | 30,000 |  |  |
| Non-Operating expenses | 8,000 |  |  |
| Net Profit | 3,00,000 |  |  |
| TOTAL | **698,000** |  | **698,000** |

**(TEE-2003)**

**PROBLEM - 18**

Extracts of some heads of account from the published final account of a

company are given below:-

Calculate GP ration, Acid test ratio, Average collection period in weeks ) and

stock turnover ratio.

|  |  |
| --- | --- |
|  | Rs. |
| Revenue(Sales) | 25,50,000 |
| Cost of goods sold | 7,01,250 |
| Closing Stock | 4,50,000 |
| Debentures | 9.00,000 |
| Cash/Bank Balance | 1,80,000 |
| Debtors | 2,20,000 |
| Bils Receivable | 1,25,000 |
| Outstanding expenses | 24,000 |
| Creditors | 1,80,000 |
| Bils Payable | 75,000 |
| Equity Capital | 12,00,000 |
| General Reserve | 7,00,000 |
| Long term loan | 5,00,000 |

(**TEE 2006**)

**PROBLEM-19**

Rs.

|  |  |
| --- | --- |
| Net Sales |  |
| Cost of goods sold | 3,00,000 |
| Net profit after tax | 2,58,000 |
| Creditors | 10,000 |
| Bills payable | 6,000 |
| Outstanding expenses | 10,000 |
| Tax payable | 13,000 |
| Cash | 20,000 |
| Stock | 30,000 |
| Sundry Debtors | 20,000 |

From the above information, calculate ratio:

1. Gross Profit Ratio
2. Net Profit Ratio
3. Quick Ratio
4. Current Ratio
5. Inventory Turnover Ratio

(**TEE 2010)**

**TOPIC 4**

**FUNDS FLOW ANALYSIS**

**Introduction**

The basic financial statements, ie, the balance sheet and profit and loss account or income

Statement of business , reveal the net effect of rhe various transacrion on the operational and financial position of the company. The balance sheet gives a summary of the assets and liabilities of an undertaking at particular point of time . It revels the financial status of the company. The assets side of a balance sheet shows the development of resources of an undertaking while he liabilities side indicates its obligations’ i.e,the manner in which these resources were obtained. The profit and loss account reflects the results of the business operations for a period of time ,it contains a summary of expenses incurred and the revenues realised in an accounting period. Both these statement provide the essential basic information on the financial activities of a business, but their usefulness is limited for analysis and planning purposes. The balance sheet gives a static view of the resources (libilities)of a business and the uses (assets) to which these resources have been put at a certain point of time.It does not disclose rhe causes for change in the assets and i liabilities between rwo different points of time .The profit and loss account,in a general way, indicates the resources provide by operations. But there are many transacrions that take place in an undertaking and which do not operate through profit and loss account. Thus,another statement has to prepared to show the changes in the assets and liabilities from the end of one peiod of time to the end of another period of time , this statement os called a Statement of changes in Financial Position or a Funds Flow Statement .

The Funds Flow Statement is a. Statement which shows the movement of funds and is a report of the financial operations of the business undertaking. It indicates the various means by which funds were obtained

during a *particular period* and the ways to which these funds were employed . in simple words it is a statement of sources of sources and applicarions of funds.

**MEANING AND CONCEPT OF FUNDS**

The terms ‘hinds’ has been defined in a number of ways

a In a narrow sense, it means cash only and a fund flow statement prepared on this basis is called a cash flow statement Such a statement enunerates net effects of the various business transactions on cash and enumerates net effects of the vatious business transactions on cash and takes into account receipts and disbursements of cash .

b In a broader sense the terms ‘funds\* refers to money values in whatever form it may exist Here funds’means all financial resources .

c In a popular sense the terms ‘funds; means working capital i.e the excess of current assets over corrent liabilities . The working capital concept of funds has emerged due to the fact that total resouces of business are invested partly in fixed assets in the form of fixed capital and are partly kept in the form of liquid or near liquid form as wkorking capital.

**Meaning of Funds Flow Statement**

Funds Flow Statement is a method by which we study change in the financial statements dates. It is a statement showing sources and uses of funds for a perios of time.

Fouke defines this statement as:

“A statement of sources and application of funds is a technical device designed to analyse the changes in the financial condition of a business enterprise between two dates”.

In the words of Anthony,”the funds flow statement describes the sources from which additional funds were derived and the use to which these sources were put.”

Thus ,funds flow statemwnt is a statement which indicates the various means by which the funds have been obtained during a certain period and the ways to which these funds have been used during that period. The terms funds used here means wording capital, i.e., the excess of current liabilities

Funds flow statment is called by various names such as sources and application of Funds:”Srarement of changes Financial Position; Sources and used of Funds ; Summary of Financial Operations:Where fone statement;Movement of /working Capital Statement; Movement of Funds statement;Funds TREceived and Disbursed Statement; Funds Fenerated and Expended Statement Sources of increases and Application of Decreases; Funds Statements,etc.

**Limitations of Funds Flow Statement.**

Funds,flow statement has a number of uses, however, it has certain limitaions also,which are listed below

1. It should be remembered that a funds flow statement is not substitute of an income statement or balance sheet. It provides only some additional information as regards changes in working capital.

2. It cannot reveal continous changes .

3. It is not a otginal statement but simply a rearrangement of data given in the financial statements.

4. It is essentially historic in nature and projected funds flow statement cannot be prepared with much

Accuracy.

5 Changes in cash are more important and relevant for financial management than working capital.

**Procedure for Preparing a Funds flow Statement**

Funds flow statement is a method by which we study changes in the financial position of a business enterprise between beginning and ending financial statement dates. Hence , the funds flow statement is prepared by comparing two balance sheets and with the help of such other infotmation derived from the accounts as may be needed. Broadly speaking , the preparation of a funds flow statement consists

of two parts:

1.Statement or Schedule of Changes in working Capital 2 Statement of Sources and

Application of Funds.

**(1)Statement or Scheduled of Changes in Working Capital**

Working Capital means the excess of current assets over current liabilities Statement of changes in working capital berween the two ba;ance sheet dates. This statement is

Prepared with the help of current liabilities deried from the two balance sheets.

As,Working Capital =Current Assets-Current Liabilities

So, i . An increase in current assets increases Working Capital .

ii . A decrease in current, as sets decreases Working Capital.

iii. An increase in current liabilities decreases Working Capital; and

iv . A decrease in current liabilities increases Working Capital .

The change in the amount of any current asset ot current liability in the current balance sheet as compared to that of the previous balance sheet either results in an increase or decrease in working capital. The difference is recorded for each individual current asset and current liability. In case a current asset in the current period is more than in the previous period, the effect is an increase in working capital and it is recorded in the increase column. But if a current liability in the current is more than in the previous period, the effect is decrease in working capital and it is recorded on the decrease column or vice-versa. The total increase and the total decrease is compared and the difference shows the net increase or net decrease in working capital. It is worth nothing that scheduleof change in working capital is prepared only from current assets and current liabilities and the other information is not any use for preparing this statement. A typical; form of statement or schedule of change in working capital is as follows;

**STATEMENT OF SCHEDULE OF CHANGES IN WORKING CAPITAL**

**(Specimen)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Particulars | Provious  Year | Current  Year | Effect on working capital | |
|  | Rs | Rs | Increase | Decrease |
| Current Assets: |  |  |  |  |
| Cash in hand | xxx | xxx |  |  |
| Cash at bank | xxx | xxx |  |  |
| Bills receivable | xxx | xxx |  |  |
| Sundry Debtors | xxx | xxx |  |  |
| Temporary Investments | xxx | xxx |  |  |
| Stocks | xxx | xxx |  |  |
| Prepaid Expenses | xxx | xxx |  |  |
| Accrued Incomes | xxx | xxx |  |  |
| **Total Current Assets** | **xxx** | **xxx** |  |  |
| ***Cuttent Liabilities*** |  |  |  |  |
| Bills Payable | xxx | xxx |  |  |
| Sundry Creditors | xxx | xxx |  |  |
| Outstanding Expenses | xxx | xxx |  |  |
| Bank Overdraft | xxx | xxx |  |  |
| Short-term advances | xxx | xxx |  |  |
| Dividends Payable | xxx | xxx |  |  |
| **Total Current Liabilities** | xxx | xxx |  |  |
| Working Capital=CA-CL | xxx | xxx |  |  |
| Net increase or Decrease in working Capital |  |  |  |  |
| **Total** | **xxx** | **xxx** |  |  |

1. Statement of Sources and Application of Funds

Funds flow statement is a statement which indicates various sources from which funds (working capital) have been obtained duting a certain period and the uses or applications to which these funds have been put during that period. Generally, this statement is prepared in two formats:

1. Report Form
2. T form or An Account Form or Self Balancing type.

**T Form or An Account Form or Self Balancing Type:**

**FUNDS FLOW STATEMENT**

**(For the year ended...........)**

|  |  |  |  |
| --- | --- | --- | --- |
| **Sources** | **Rs** | **Applications** | **Rs** |
| Funds from Operations | xxx | Funds lost in Operations | xxx |
| Issue of Share Capita | xxx | Redemption of Preference Sare capital | xxx |
| Raising of long-term loans | xxx | Redemption of Debentures | xxx |
| Receipts from partly paid shares, called up | xxx | Repayment of long-term loans | xxx |
| Sale of non-current (fixed) assets | xxx | Purchase of non-current (fixed) assets | xxx |
| Non-trading receipts such as dividentds | xxx | Purchase of long-term investments | xxx |
| Sale of long –term investments | xxx | Non-trading payments | xxx |
| Net Decrease in Working | xxx | Payment of dividents | xxx |
| Capital | xxx | Net Increase in working capital | xxx |
|  | **xxx** |  | **xxx** |

Sources of Funds

The following are the sources which funds, generally, flow (come) into the business:

1. **Funds from Operations or Trading Profits**

Trding Profits or the profits from the operations of the business are the most improtant and major source of funds. Sales are the main source of inflow of funds into the

business as they increase current assets (cash, debtors or bills receivable) but at the same time funds flow out of business for expenses and cost of goods sold. Thus, the net effect of operations will be a source of funds if inflow from sales exceeds the outflow for expenses and cost of goods sold and vice-versa. But it must be remembered that funds from operations do not necessarily mean the profit as shown by the profit and loss account of firm. Because there are many non-fund or non-operating items which may

have been either debited or credited to profit and loss account. The examples of such items on the debit side of a profit and loss account are: Amortization of fictitious and intangible assets such as goodwill, preliminary expenses and discount on issue of

shares and debaters written off: Depreciation and delectation; Loose on sale of fixed assests: payment of divident, etc. The non fund items are those whcih may be

operational expenses but that do not affect funds of the business, e.g. for depreciation charged to profit and loss account, funds really do not move out of business. Non- operating items are those which although may result in the outflow of funds but are not

related to the trading operations of the business such as loss on sale of machinery or

payment of dividends. So the problem arises, how to find out funds from operations?

Basically, there are two methods of calculating funds from operations:

1. The first methods is to prepare the profit and loss account afresh by taking into

Consideration only fund and operational item which involve funds and are related to the normal operations of the business. The balancing figure in this case will be either funds generated from operations or funds lost in operations depending upon whether the income or credity side of profit and loss account or vice-versa.

Funds from operations can also be calculted by preparing adjusted profit and loss account as follows:

**ADJUSTED PROFIT AND LOSS ACCOUNT (Specimen)**

|  |  |  |  |
| --- | --- | --- | --- |
| To Depreciation | xxx | By Opening Balance (of P & L a/c)---1st year | xxx |
| “ Amortization of fictitious and intangible assets, scuh as : Goodwill, patents, Trade Marks, Preliminary Expenses, etc. | xxx | By Appreciation in the value of fixed assests | xxx |
| To Transfers to General Reserve, Dividents Equalization Fund, Sinking fund etc. | xxx | By Dividends received | xxx |
| To loss on sale of any fixed assets | xxx | By Profit on sale of fixed assets | xxx |
| To Proposed Dividend (if not taken as current liability) | xxx | By **Funds from operations**  (balancing figure in case Debt side exceeds Credit side) | xxx |
| To Provision for taxation (if not taken as a current liability) | xxx |  |  |
| To Closing Balance (P&L a/c)-2nd year | xxx |  |  |
| To Funds lost in oeprations(balancing figure, in case credit side exceeds the debit side) | xxx |  |  |
| **TOTAL** | **XXX** |  | **xxx** |

**HOW TO PREPARE FUNDS FLOW STATEMENT**

**STEP -1**

**STEP 2**

**STEP 3**

BALANCE SHEETS

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Liabilities | Year 1  (Rs.) | Year 2  (Rs.) | Assets | Year  1  (Rs.) | Year 2  (Rs.) |
| Current  Liabilities | xxx | xxx | Current  Assets | xxx | xxx |
| Fixed/long  Term  Liabilities | xxx | xxx | Fixed  Assets | xxx | xxx |
| Profit and  Loss A/c | xxx | xxx |  |  |  |
| Total | xxx | xxx | Total | xxx | xxx |

**ADVANCED PROBLEMS**

**PROBLEMS - 1**

Prepare a statement of changes in working capital from the following Balance Sheets of Manjit and Company Limitted.

**Balance Sheets as at December 31**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Liabilities | 1990 | 1991 | Assets | 1990 | 1991 |
|  | Rs. | Rs. |  | Rs. | Rs. |
| Equity Capital | 5,00,000 | 5,00,000 | Fixed Assets | 6,00,000 | 7,00,000 |
| Denture | 3,70,000 | 4,50,000 | Investment | 2,00,000 | 1,00,000 |
| Tax Payable | 77,000 | 43,000 | Work-in-Progress | 80,000 | 90,000 |
| Accounts Payable | 96,000 | 1,92,000 | Stock-in-trade | 1,50,000 | 2,25,000 |
| Interest payable | 37,000 | 45,000 | Accounts receivable | 70,000 | 1,40,000 |
| Dividends Payable | 50,000 | 35,000 | Cash | 30,000 | 10,000 |
|  | 11,30,000 | 12,65,000 |  | 11,30,000 | 12,65,000 |

**PROBLEM-2**

The Balance Sheet of Sun Limited at the end of 1997 and 1998 are given below. You are required to preapare a Schedule of changes in working capital.

|  |  |  |
| --- | --- | --- |
| **Assets** | 1997  Rs. | 1998  Rs. |
| Land and Building | 1,00,000 | 1,00,000 |
| Plant at Cost | 1,04,000 | 1,00,000 |
| Furniture at Cost | 7,000 | 9,000 |
| Investment at Cost | 60,000 | 80,000 |
| Debtors | 30,000 | 70,000 |
| Stock | 60,000 | 65,000 |
| Cash | 30,000 | 45,000 |
| **TOTAL** | **3,91,000** | **4,69,000** |
|  |  |  |
|  |  |  |
| **Liabilities** |  |  |
| Share Capital | 1,00,000 | 1,50,000 |
| Share Premium | ------ | 5,000 |
| General Reserve | 5,0000 | 60,000 |
| P & L a/c | 10,000 | 17.000 |
| 5% Debentures | 70,000 | 50,000 |
| Provision for Depreciation on plant | 50,000 | 56,000 |
| Provision for depreciation of furniture | 5,000 | 6,000 |
| Provision for Taxation | 20,000 | 30,000 |
| Sundry Creditors | 86,000 | 95,000, |
| **TOTAL** | **3,91,000** | **4,69,000** |

**(TEE, 1999)**

**PROBLEM-3**

The following are the summarized balance sheets of Bistro Hotel as on 31st Dec 1996 and 1997

You are required to prepare:

1. A statement showing changes in the working capital
2. A statement of sources and application of funds

|  |  |  |
| --- | --- | --- |
| Particulars | 1996  (Rs.) | 1997  (Rs.) |
| ASSETS |  |  |
| Bank balance | 42,000 | 32,000 |
| Sundry debtors | 38,000 | 38,000 |
| Bills receivable | 42,000 | 62,000 |
| Stock in hand | 84,000 | 98,000 |
| Machinery | 2,00,000 | 2,30,000 |
| Building | 1,50,000 | 1,72,000 |
| Land | 18,000 | 22,000 |
|  | **5,74,000** | **6,54,000** |
|  |  |  |
| Particulars | 1996 | 1997 |
| CAPITAL & LIABILITIES |  |  |
| Share capital (equity) | 2,20,000 | 2,50,000 |
| Share capital (Preference) | 1,00,000 | 1,10,000 |
| Share premium | 20,000 | 26,000 |
| Profit and loss account | 1,04,000 | 1,34,000 |
| Debentures | 70,000 | 64,000 |
| Dividends payable | 7,000 | 8,000 |
| Provision for taxes | 10,000 | 12,000 |
| Bills payable | 5,000 | 4,000 |
| Sundry creditors | 38,000 | 46,000 |
|  | **5,74,000** | **6,54,000** |

**(TEE, 1998)**

**PROBLEM-4**

From the following two balance sheets as on 31-12-1995 and 31-12-1996, you are required to prepare

a statement of sources and application of funds, with a supporting shedule of working capital.

|  |  |  |
| --- | --- | --- |
|  | December 31 | |
|  |  |  |
| ASSETS | Rs. Ps. | Rs. Ps |
| Cash | 50,000.00 | 67,000.00 |
| Debtors | 1,40,000.00 | 1,35,000.00 |
| Stock in Trade | 80,000.00 | 90,000.00 |
| Investment | 80,000.00 | 96,000.00 |
|  | **3,50,000.00** | **3,88,000.00** |
|  |  |  |
| CAPITAL & LIABILITIES |  |  |
| Share Capital | 2,25,000.00 | 2,75,000.00 |
| Trade Creditors | 1,00,000.00 | 75,000.00 |
| Retained Earnings | 25,000.00 | 38,000.00 |
|  | **3,50,000.00** | **3,88,000.00** |

(**TEE, 1998)**

**PROBLEM- 5**

From the following two balance sheets as on 31-12-1995 and 31-12-1996 you are required to prepare a Funds Flow Statement with a Supporting Schedule of working capital.

|  |  |  |
| --- | --- | --- |
|  | 1995 | 1996 |
| ASSETS | Rs. Ps. | Rs. Ps |
| Bank Balance | 2,00,000.00 | 1,50,000.00 |
| Sundry Debtors | 50,000.00 | 75,000.00 |
| Closing Stock | 50,000.00 | 75,000.00 |
| Land and Building | 9,00,0000.00 | 10,00,000.00 |
|  | **12,00,000** | **13,00,000** |
| CAPITAL & LIABILITIES |  |  |
| Share capital | 10,00,000.00 | 10,50,000.00 |
| Sundry Creditors | 50,000.00 | 40,000.00 |
| Profit and loss account | 1,50,000.00 | 2,10,000.00 |
|  | **12,00,000.00** | **13,00,000.00** |

**(TEE 1997)**

**PROBLEM - 6**

From the figures gien below. Prepare a Statement Showing the Applications and Sources of Funds during the year 1989.

|  |  |  |
| --- | --- | --- |
|  | Dec. 31, 1988 | Dec. 31, 1989 |
| ASSETS | Rs. Ps. | Rs. Ps. |
| Fixed Assets (net) | 5,10,000.00 | 6,20,000.00 |
| Investments | 30,000.00 | 80,000.00 |
| Current Assets | 2,40,000.00 | 375,000.00 |
| Discount o debentures | 10,000.00 | 5,000.00 |
|  | **7,90,000** | **10,80,000.00** |
| LIABILITIES AND CAPITAL |  |  |
| Share capital (equity) | 3,00,000.00 | 3,50,000.00 |
| Shae Capital (Preference) | 2,00,000.00 | 1,00,000.00 |
| Debentures | 1,00,000.00 | 2,00,000.00 |
| Reserves | 1,10,000.00 | 2,70,000.00 |
| Provision for doubtful debts | 10,000.00 | 15,000.00 |
| Current Liabilities | 70,000.00 | 1,45,000.00 |
|  | **7,90,000.00** | **10,80,000.00** |

**(TEE 1996)**

**PROBLEM -7**

On the basis of the following Balance Sheets of a Sea food Restaurant, you ae required to prepare a statement of Changes Working Capital and a Funds Flow Statement.

|  |  |  |
| --- | --- | --- |
|  | As on Dec. 31, 12, 1993 | As on 31, 12,  1994 |
| ASSETS | Rs. Ps. | Rs. Ps. |
| Restaurant Building | 5,00,000 | 7,00,000 |
| Kitchen Equipment | 2,40,000 | 3,40,000 |
| Inventory | 90,000 | 70,000 |
| Guest Balance (Debtors) | 1,65,000 | 1,95,000 |
| Bank | 40,000 | 90,000 |
|  | **10,35,000,** | **13,95,000** |
|  |  |  |
| Shares Capital | 8,00,000 | 9,00,000 |
| Profit and Loss Account | 1,45,000 | 2,45,000 |
| Suppliers Account ( Creditors) | 90,000 | 50,000 |
| Debentures |  | 2,00,000 |
|  | **10,35,000** | **13,95,000** |

**(TEE-1995)**

**PROBLEM -8**

From the following two balance sheets as on 31-12-1998 and 1989 you are required to prepare a statement of sources and Application of Fund with a supporting Schedulej of Working Capital.

|  |  |  |
| --- | --- | --- |
|  | Dec. 31,  1988 | Dec. 31,  1989 |
| ASSETS | Rs. | Rs. |
| Cash | 30,000 | 47,000 |
| Debtors | 1,20,000 | 1,15,000 |
| Stock in Trade | 80,000 | 90,000 |
| Land | 50,000 | 66,000 |
| **TOTAL** | 2,80,000 | 3,18,000 |
|  |  |  |
| CAPITAL & LIABILITY |  |  |
| Share Capital | 2,00,000 | 2,50,000 |
| Trade Creditor | 70,000 | 45,000 |
| Retained earnings | 10,000 | 23,000 |
| **TOTAL** | 2,80,000 | 3,18,000 |

**PROBLEM - 9**

From the following Balance Sheet of the Company for the year ending 31st December 1997 and 31st December 1998 prepare Schedule of jChanges in working Capital and a Statement showing Sources and Application of Funds.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | 31st December | |  | 31st December | |
| Liabilities | 1997 | 1998 | Assets | 1997 | 1998 |
|  | Rs. | Rs. |  | Rs. | Rs. |
| Share Capital | 3,00,000 | 4,00,000 | Plant & Machinery | 50,000 | 60,000 |
| Sundry Creditors | 1,00,000 | 70,000 | Furniture and Fixtures | 10,000 | 15,000 |
| P & L Account | 15,000 | 30,000 | Stock in Trade | 85,000 | 1,05,000 |
|  |  |  | Debtors | 1,60,000 | 1,50,000 |
|  |  |  | Cash | 1,10,000 | 1,70,000 |
|  | **4,15,000** | **5,00,000** |  | **4,15,000** | **5,00,000** |

**(TEE, 2000)**

**PROBLEM-10**

From the given balance sheet, calulate:

1. Changes in working capital
2. Fund Flow Statement

**BALANCE SHEET OF SKYVIEW HOTELS**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Liabilities | 2005 | 2006 | Assets | 2005 | 2006 |
| Capital | 5,00,000 | 6,50,000 | Fixed Stock | 5,50,000 | 6,50,000 |
| Profit & Loss Account | 50,000 | 75,000 | Preliminary Expenses | 20,000 | 15,000 |
| Creditors | 35,000 | 25,000 | Cash in hand | 20,000 | 25,000 |
| Bills payable | 25,000 | 15,000 | Cash at Bank | 50,000 | 75,000 |
| Debentures | 90,000 | 20,000 | Stock | 15,000 | 10,000 |
|  |  |  | Bills Receivable | 45,000 | 10,000 |
| **TOTAL** | **7,00,000** | **7,85,000** | **TOTAL** | **7,00,000** | **7,85,000** |

**(TEE 2007)**

**PROBLEM-11**

Following is the summarized Balance sheet of Mumbai Industries Ltd. as on 31st

December 1998 and 1999

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Liabilities | 1998  Rs. | 1999  Rs. | Assets | 1998  Rs. | 1999  Rs. |
| Sundry Creditors | 40,400 | 43,200 | Cash at Bank | 44,600 | 47,800 |
| Bils Payable | 10,800 | 12,200 | Debtors | 10,800 | 17,000 |
| Outstanding Rent | 2,600 | 1,000 | Stock in trade | 44,000 | 67,200 |
| Mortgage Loan | 22,000 | 21,000 | Emporary investment | 30,200 | 8,000 |
| Share capital | 2,80,000 | 3,20,000 | Plant & Machinery | 2,54,600 | 3,35,800 |
| Reserve | 1,12,600 | 1,31,600 | Land | 50,000 | 50,000 |
| Proposed Dividend | 28,000 | 32,000 | Long term investment | 62,200 | 35,200 |
| **TOTAL** | **4,96,400** | **5,61,000** | **TOTAL** | **4,96,400** | **5,61,000** |

You are required to prepare a schedule of changes working capital and a statement flow of funds.

**(TEE 2001)**

**PROBLEM-12**

Hotel Moonlight earned a net profit of Rs.20.00 Lakhs during the period ending 31st March,

2000 after charging depreciation of Rs. 5.00 lakhs. Dividends paid during the year amounted to

Rs.10.00 lakhs.

You are required to prepare a Fund Flow Statement from the following summarized Balance sheet taking into consideration the above mentioned information.

**Hotel Moonlight**

**Summarised Balance Sheet**

**(Rupees in Lakhs)**

|  |  |  |
| --- | --- | --- |
| **Assets** | March 31, 1999 | March 31, 2000 |
| Cash | 10 | 15 |
| Receivables | 20 | 25 |
| Inventory | 20 | 35 |
| Fixed Assets (at cost) | 85 | 95 |
| Less: Accumulated Depreciation | (15) | (20) |
| Total Assets | 120 | 150 |
|  |  |  |
| **Liabilities & Capital** |  |  |
| Sundry Creditors | 8 | 10 |
| Outstanding Expenses | 7 | 10 |
| Debentures | 10 | 5 |
| Long-term loans | 5 | 25 |
| Share Capital | 50 | 50 |
| Retained earnings | 40 | 50 |
|  | 120 | 150 |

**(TEE 2002)**

**PROBLEM-13**

From the given balance sheet calculate

1. Schedule of changes in working capital
2. Funds flow statement

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **BALANCE SHEET OF M/S NARAIN & CO** | | | | | |
| Liabilities | 2001 | 2002 | Assets | 2001 | 2002 |
| Share Capital | 6,50,000 | 7,80,000 | Fixed Assets | 8,30,000 | 8,60,000 |
| Profit & Loss Account | 40,000 | 65,000 | Stock | 2,90,000 | 3,70,000 |
| Debentures | 3,00,000 | 2,50,000 | Cash in Hand | 80,000 | 90,000 |
| Creditors | 1,70,000 | 1,60,000 | Prepaid Expenses | 10,000 | 15,000 |
| Bills Payable | 40,000 | 50,000 | Preliminary expenses, | 10,000 |  |
| Outstanding bills | 20,000 | 30,000 |  |  |  |
| Total | **12,20,000** | **13,35,000** | **TOTAL** | **12,20,000** | **13,35,000** |

**(TEE 2004)**

**PROBLEM-14**

**You are required to prepare a fund flow statement from the following**

**Summarized balance sheets.**

**SUMMARIZED BALANCE SHEET**

**(Rupees in lakhs)**

|  |  |  |  |
| --- | --- | --- | --- |
| **March 31, 2004 March 31, 2005** | | | |
| **Assets** | | | |
| Cash |  | 20.00 | 30.00 |
| Receivables |  | 40.00 | 50.00 |
| Inventory |  | 40.00 | 70.00 |
| Fixed Assets |  | 170.00 | 190.00 |
| Total 270.00 340.00 | | | |
| Liabilities & Capital | | | |
| Sundry Creditors |  | 16.00 | 20.00 |
| Outstanding expenses |  | 14.00 | 20.00 |
| Debentures |  | 20.00 | 10.00 |
| Long term loans |  | 40.00 | 50.00 |
| Share Capital |  | 100.00 | 100.00 |
| Retained earnings |  | 80.00 | 140.00 |
| Total 270.00 340.00 | | | |

**(TEE 2005)**

**PROBLEM-15**

Prepar a Funds Flow Statement for the year 2009 from the following

Balance Sheet:

**BALANCE SHEET AS ON 31St March 2009**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Liabilities** | **2008** | **2009** | **Assets** | **2008** | **2009** |
| Share Capital | 5,00,000 | 6,00,000 | Fixed Assets | 5,00,000 | 6,00,000 |
| Sundry Creditors | 10,000 | 12,000 | Cash in hand | 17,000 | 16,000 |
| Outstanding expenses | 8,000 | 5,000 | Sundry Debtors | 8,000 | 11,000 |
| Bills Payable | 5,000 | 6,000 | Investment | 10,000 | 15,000 |
| Provision for tax | 12,000 | 19,000 |  |  |  |
|  | **5,35,000** | **6,42,000** |  | **5,35,000** | **6,42,000** |

**(TEE 2010)**

**PROBLEM-16**

From the following Balance Sheet of a Company, prepare a schedule

of change in working capital and a statement showing sources and application

of funds as on 31.12.2004.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Liabilities** | **31.12.03** | **31.12.04** | **Assets** | **31.12.03** | **31.12.04** |
| Share Capital | 3,00,000 | 4,00,000 | Plant & Other Fixed Assets | 1,00,000 | 1,50,000 |
| Profit & Loss | 20,000 | 50,000 | Stock | 40,000 | 60,000 |
| Sundry Creditors | 1,20,000 | 1,00,000 | Debtors | 1,70,000 | 1,50,000 |
|  |  |  | Cash | 1.30,000 | 1,90,000 |
| **Total** | **4,40,000** | **5,50,000** |  | **4,40,000** | **5,50,000** |

**(TEE 2005 and 2009)**

**PROBLEM-17**

From the summarized Balance Sheet given below, prepare a Fund

Flow statement for year 1976.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Liabilities** | **1975** | **1976** | **Assets** | **1975** | **1976** |
|  | Rs. | Rs. |  | Rs. | Rs. |
| Share Capital | 10,000 | 15,000 | Cash | 5,000 | 8,000 |
| Profit & Loss A/c | 5,000 | 8,000 | Debtors | 10,000 | 15,000 |
| Reserves | 4,000 | 6,000 | Stock | 10,000 | 12,000 |
| Creditors | 8,000 | 12,000 | Machinery | 3,000 | 5,000 |
| Bills payable | 5,000 | 3,000 | Land | 4,000 | 4,000 |
|  | **32,000** | **44,000** |  | **32,000** | **44,000** |

**(TEE 2006,2008)**

**PROBLEM-18**

Calculate Fund From Operations from the following information:-

|  |  |  |
| --- | --- | --- |
|  | Year | |
|  | 1999  (Rs.) | 2000  (Rs.) |
| Profit & Loss Appropriation Account | 30,000 | 40,000 |
| General Reserve | 20,000 | 25,000 |
| Goodwill | 10,000 | 5,000 |
| Preliminary Expenses | 6,000 | 4,000 |
| Provision for depreciation on machinery | 10,000 | 12,000 |

**(TEE 2005)**

**PROBLEM-19**

Prepare a Fund Flow Statement for the year 2006 from the following Balance

Sheet

**BALANCE SHEET AS AT DECEMBER, 2006**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Liabilities | 2005(Rs.) | 2006(Rs.) | Assets | 2005(Rs.) | 2006(Rs.) |
| Share  Capital | 6,00,000 | 7,00,000 | Stock | 8,00,000 | 8,50,000 |
| P&L App.  A/c | 40,000 | 1,00,000 | Cash in  Hand | 2,35,000 | 2,50,000 |
| Debentures | 3,00,000 | 2,50,000 | Prepaid  Expenses | 75,000 | 90,000 |
| Creditors | 1,50,000 | 1,00,000 | Preliminary  Expenses | 10,000 | 20,000 |
| Bills  Payable | 40,000 | 60,000 | Total | 10,000 | -------- |
| **Total** | **11,30,000** | **12,10,000** | **Total** | **11,30,000** | **12,10,000** |

**(TEE-2008)**

**TOPIC-5**

**CASH FLOW ANALYSIS**

**Introduction & Meaning**

Cash plays a very important role in the entire economic life of a business. A film needs cash to

make payments to its suppliers, to incur day-to-day expenses and to pay salaries, wages, interest and dividends, etc. In fact, what blood is to a human body, cash is to a business enterprise. It is very essential for a business to maintain adequate balance of cash. But many a times, a concern operates profitably and yet it becomes very difficult to pay taxes and dividents. This may be because (o) although huge profits have been received, it may have drained out(used)for some

other purpose. This movements of cash is of vital importance to the management.

We have disussed in the previous chapter on Funds Flow Statement, that the term ‘funds’ in a narrow sense, is used to denote cash. A statement of changes in the financial \ position of a firm

on cash bases is called a cash flow statement. Such a statement enumerates net effects of the various business transactions on cash and takes into account receipts disbursements of cash. A easily flow statement summarises the ‘causes of changes in cash position of a business enterprise between dates of two balance sheets. This statement is very much similar tc the statement of changes in financial position prepared on working capital basis. i.e. a funds flow statement except that cash flow statement focuses attention on cash instead of working capital. It is called a cash flow statement because it describes the inflow (sources) and outflow (uses) of cash.

**Distinction Between Fund Flow Statement and Cash Flow Statement**

The term ‘funds’ has a variety of meanings. In a narrow senses, it means. Cash and the

statement of changes in the financial position prepared on cash basis is called a cash flow statement. In the most popular sense, the term ‘funds’ refers to working capital and a statement of changes in the financial position prepared on this basis is called a funds flow statement. A cash

flow statement is much similar to a funds flow statement as both are preapred to summarise the causes of changes

in the financial position of a business However following are the main differences between a fund flow and a cash flow statement.

**Funds Flow Statement Vs Cash Flow Statement**

|  |  |  |
| --- | --- | --- |
| **Sl.No** | **Funds Flow Statement** | **Cash flow Statement** |
| 1 | It is based on working capital  Concept of funds | It is based on cash concept of funds |
| 2 | It is a main statement | It is a supplement to funds flow  Statement |
| 3 | A separate schedule of changes in  Working capital required | Not required |
| 4 | It deals with accrual items also  Including provision and pre payments | It ignores the accrual concept |
| 5 | It is an extension of balance sheet | It is prepared form basic data |
| 6 | It this, sources and application of  Funds are matched and reconciled | It starts with the opening balance of  cash and ends with closing balance  of cash |
| 7 | Classification of current and non  Current is relevant | such classification is not required in  this case |
| 8 | It is more useful for long term  Planning | It is more useful in short term  planning |
| 9 | It includes the transactions also  Which do not involve cash | It is excludes all transaction which  do not involve cash |

**Limitations of Cash Flow Statements**

Despite a number of uses, Cash flow statements~~5uffer from the following

limitations

1. It is difficult to precisely define the term ‘cash’. There are controversies

over a number of items like cheques, stamps, postal orders, etc. to be

Included in cash

1. A cash flow statement revealsj the inflow and outflow of cash but the

exclusion of hear cash items from cash obscures the true reporting of the

firm’s liquidity position.

1. Working Capital being a wider concept of funds, a funds flow statement Presents a more complete picture than cash flow statement.

Procedure for preparing a cash flow Statement.

Cash flow statement shows the impact of various transactions on cash position of a firm. It is preapred with the help of financial statements ie. Balance sheet and profit and loss acount and some additional information. Cah flow statement starts with the opening balance of cash and balance at bank, allthe

inflows of cash are added to the opening balance of cash and balance outflow of cash are deducted from the total. The balance ie. Opening balance of cash and bank balance of cash. The preparation of cash flow statement invoves the determinig of:

1. Inflows of cash
2. Outflows of cash
3. Sources of Cash inflows

The main sources of cash inflows are :

1. Cash flow from operations.
2. Increase in existing liabilities or creation of new liabilities
3. Reduction in or Sale of Assets
4. Non-trading Receipts.

b) Appilcation of Cash or Cash outflows

Cash lost in operators.

2) Decrease in or discharge of liabilities

3) Increase in or Purchase of Assets.

4) Non-trading payments.

Generally, cash flow statement is prepared in two forms:

1. Report from
2. T Form or an Account Form or Self Balancing Type.

**Cash Operating Profit**

Cash operating profit is also calculated with the help ofnet profit ornet loss. The difference in this method

as compared to the above discussed methods is that increase or decreases in accounts payable and accounts receivable is not adjusted while finding cash from operations and it is directly shown in the cash flow statment as an inflow or outflow of cash as the. Case may be. The cash from operation so calculated is generally called operating profit.

Application of Cash or Cash Outflows

i Cash lost in operations Sometimes the net result of trading in a particular period is a loss some cash

may be lost during that period in trading operations. Such loss of cash in trading is called cash lotin operations and is shown as an outflow of cash in Cash Flow Statement.

2 Decrease in or dischange of liabilities. Decrease in or discharge of any liability fixed or current, results

in outflow cash either actual or notional. For example, when redeemable preference shares are repaid, it will amount to an outflow of actual cash But when one liability is converted into another such as issue of shares for debentures, there will be a notional flow of cash into the business.

3 Increases in or purchase of Assets Just like decreases in or sasle of sale of assets is a source or inflow of cash, increase or purchase of any assests is an outflow or application of cash

4 Non-trading payments Payment of any non-trading expenses also constitute outflow of cash For

example, Payment of income tax etc

**PROBLEM -1**

The following is the position of current assets and current liabilities

Calculate cash from operation

|  |  |  |
| --- | --- | --- |
|  | Year | |
|  | **1999**  **(Rs.)** | **2000**  **(Rs.)** |
| Debtors | 12,000 | 15,000 |
| Creditors | 15,000 | 10,000 |
| Bills Receivable | 10,000 | 8,000 |
| Prepared expense | 6,000 | 4,000 |

**(TEE 2005)**

**PROBLEM- 2**

Compute Cash flow from Operations Activities from the following:-

|  |  |  |
| --- | --- | --- |
|  | Year | |
|  | **2004**  **(Rs.)** | **2005**  **(Rs.)** |
| Profit and Loss Account | 25,000 | 35,000 |
| Depreciation | 25,000 | 45,000 |
| Goodwill | 15,000 | 16,000 |
| Debtors | 10,000 | 12,000 |
| Prepaid Insurance | 9,9000 | 11,000 |

**(TEE 2007)**

**PROBLEM-3**

From the following information, you are required to ascertain cash from

operation during the year 2

|  |  |  |
| --- | --- | --- |
|  | **Year I (Rs.)** | **Year II (Rs)** |
| Net Profit |  | 70,000 |
| Debtors | 42,000 | 40,000 |
| Bills receivable | 8,000 | 13,000 |
| Creditors | 47,000 | 50,000 |
| Bills payable | 15,000 | 10,000 |
| Stock | 58,000 | 65,000 |

**(TEE-2008)**

**PROBLEM-4**

Following are the summarized Balance Sheet of ABC Ltd. as on 31st March

1998 and 1999. Prepare a statement of cash flow.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Liabilities | 1998  Rs. | 1999  Rs. | Assets | 1998  Rs. | 1999  Rs. |
| 9%  Redeemable preference shares | ------ | 10,000 | Fixed Assets | 41,000 | 40,000 |
| Equity shares | 40,000 | 40,000 | Less:  Depreciation | 11,000 | 15,000 |
|  |  |  |  | 30,000 | 25,000 |
|  |  |  |  |  |  |
| General Reserve | 2,000 | 2,000 | Debtors | 20,000 | 24,000 |
| Profit & Loss Account | 1,000 | 1,200 | Stock | 30,000 | 35,000 |
| Debentures | 6,000 | 7,000 | Prepared expenses | 300 | 500 |
| Creditors | 12,000 | 11,000 | Cash | 1,200 | 3,500 |
| Provision for taxation | 3,000 | 4,200 |  |  |  |
| Proposed Dividend | 5,000 | 5,800 |  |  |  |
| Bank overdraft | 12,500 | 6,800 |  |  |  |
|  | 81,500 | 88,000 |  | 81,500 | 88,000 |

**(TEE 2001)**

**PROBLEM-5**

Prepare a cash flow statement from the following balance sheet:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Liabilities | 2000 | 2,50,000 | Assets | 2000 | 2001 |
| Equity capital | 2,50,000 | 2,25,000 | Fixed Assets | 3,00,000 | 3,50,000 |
| Debentures | 1,85,000 | 21,500 | Investments | 1,00,000 | 50,000 |
| Tax payable | 38,500 | 96,000 | Closing stock | 1,15,000 | 1,57,000 |
| Interest payable | 48,000 | 22,500 | Accounts receivable | 35,000 | 70,000 |
| Retained earnings | 18,500 | 17,500 | Cash | 15,000 | 5000 |
| Total | 25,000 | 6,32,500 | Total | 5,65,000 |  |

(TEE-2005)

PROBLEM- 6

From the following calculate cash from operation:

1. Profit made during the year 2,50,000 after considering the following items:-
2. Depreciation of fixed assets Rs. 10,000/-

ii Amortization of Goodwill Rs. 5000/-

iii Transfer to General Reserve Rs. 7,000/-

iv Profit on sale of land Rs. 3,000/-

**(TEE 2005)**

**PROBLEM- 7**

Prepare a cash Flow statement from the summarized Balance sheet given below:-

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Liabilities | 1998  (Rs.) | 1999  (Rs.) | Assets  (Rs.) | 1998  (Rs.) | 1999  (Rs.) |
| Share  Capital | 3,00,000 | 4,00,00 | Plant &  Machinery | 50,000 | 60,000 |
| P & L A/c | 15,000 | 30,000 | Furniture  & Fixture | 10,000 | 15,000 |
| Creditors | 1,00,000 | 70,000 | Stock | 85,000 | 1.05,000 |
|  |  |  | Debtors | 1,60,000 | 1,50,000 |
|  |  |  | Cash | 1,10,000 | 1,70,000 |
|  | 4,15,000 | 5,00,000 |  | 4,15,000 | 5,00,000 |

(**TEE 2006)**

**PROBLEM- 8**

Prepare a Cash Flow Statementas per the revised AS3 format

|  |  |  |
| --- | --- | --- |
| BALANCE SHEET OF TINKLERS INC. ON 31ST DECEMBER 2002 | | |
| LIABILITIES | 2001 | 2002 |
| Equity Share capital | 3,00,00 | 3,00,000 |
| General Reserve | 40,000 | 1,00,000 |
| Preference Shares @ 10% | --- | 50,000 |
| Denentures @ 12% | --- | 50,000 |
| Sundry Creditors | 1,00,000 | 86,000 |
| Provision for dividend | 10,000 | 12,000 |
| Provision for Tax | 5,000 | 10,000 |
| Profit & Loss A/c | 15,000 | 30,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| ASSETS |  | 2001 |  |  |
| Plant & Machinery  Less: Depreciation | 1,10,000 | 1,00,000 | 2,25,000  15,000 | 2,10,000 |
| Furniture & Fixtures  Less: Depreciation | 10,000 | 10,000 | 21,000 | 19,000 |
| Investment in Bank FDS | 11,000 | 15,000 | 2,000 | -- |
| Stock | 1,000 | 15,000 |  | 1,05,000 |
| Debtors |  | 1,62,000 |  | 1,32,000 |
| Cash |  | 98,000 |  | 1,72,000 |
|  |  | **4,70,000** |  | **6,38,000** |

**(TEE 2006)**

**PROBLEM -9**

Prepare a Cash Flow Statement for the year 2009 from the following Balance Sheets.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Liabilities | 2008 | 2009 | Assets | 2008 | 2009 |
| Total Current liabilities | 10,000 | 20,000 | Total fixed assets | 60,000 | 85,000 |
| Equity shares | 50,000 | 80,000 | Sundry debtors | 15,000 | 18,000 |
| Bank loan | 10,000 | 15,000 | Marketable  securities | 10,000 | 20,000 |
| Profit & Loss account | 15,000 | 18,000 | Cash in hand | 5,000 | 12,000 |
| Proposed dividend | 5,000 | 2,000 |  |  |  |
|  | 90,000 | 1,35,000 |  | 90,000 | 1,35,000 |

**(TEE-2010)**

**TOPIC - 6**

**FINANCIAL PLANNING – MEANING AND SCOPE**

Planning is very necessary for the smooth running of the business. A business cannot be carried on without planning. Planning means deciding in advace what is to be done. It is primary funcition and achieves primary position over other functions. It is a continues and never ending process. Planning is a preparatory step for actions to be followed. According to Koontz O’ Donnel, planning is “ an intellectual process, the conscious determination of courses of action, the basis of decision on purpose, facts and considered estimates.”

Planning is done for each functional area of management and acts accordingly. The planning of each area shoul be linked to the objectives of the organisation.

Financial management, being one of the branches of the management also needs planning. Financial planning is necessary for the control of inflow and outflow of cash so that necessary funds may be made available as and when they are required. T he highest earnings can be assured only through sound financial planning is necessary to achieve the long-term and the short-term objectives of the firm and to protect the interests of all parties concerned i.e. firm, creditors, shareholders and public.

**MEANING OF FINANCIAL PLANNING**

Financial planning means deciding in advance, the financial activities to be carried on to achieve the basic objectives of the firm is to get maximum profits out of minimum efforts or to maximise the wealth of the corporation to its shareholders in an efficient manner. So the basic purpose of the financial planning is to make sure that adequate funds are raised at the minimum cost (Optimal financial ) and that they be used wisely. Thus planners of financial policies must see that adequate finances are available with the concern when they are required because an inadequate supply of funds will hamper operations and may lead to difficulties. Too much capital, on the other has, means lower rearning to the unit holders because idle capital will earn nothing. A proper planning is therefore necessary for the smooth running of

the business on the one hand and o allow a fail return to the share holders on their contributions. The meaning of financial planning may be well understood with the help of the following defintions:-

The financial plan of a corporation has twofold aspects: it refers not to the capital structure of the corporation, but also to the financial policies which the corporation has adopted or intends to adopt.”

J.H. Bouneivlle.

The above definition stress on two aspects of financial planning i.e. i (i) determination of capital structure of the corporation, and (2) formulation of financial policies to be adopted.

Financial planning pertains only to the function of finance and includes the determination of the firm’s financial objectives formulating and promulgating financial policies and developing financial procedures.”

Walker and Boughm

This definition is considered to be the best definition on financial planning. It ncludes three mai aspets of financial planning. (0 determination of financial objectives

**Main Aspects of Financial Planning**

The above definition of Walker and Boughm includes three main aspects of the financial planning.

**Meaning of Over-capitalisation**

A company is said to be overcapitalized when its earnings are not sufficient to yield a fair return on the amount of shares of debentures. In other words, when a company is not in a position to pay dividends and interests on its shares and debentures at fair rates, it is said to be over capitalilzed. It means that an over-capitalised company is unable to pay a fair return on its capital investment. A fe definitions of ‘over- capitalisation may wel explain its meaning well-to pay divdends and interests on its shares and debentures at fairrates, it is said to be over capitalised. It means that an over-capitalised company is unable to pay a fair fefurnori its capital investment. A fe definitions of over-capitalisation may well explain its meaning well-

1. ‘Whenever the aggregate of the par values of stocks and bonds outstanding exceed the

true value of the fixed assets the corporation is said to be over-capitalised.”

**Hoagkind**

1. “A corporation is over capitalised when its earnings are not large enough to yield 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 assets’

**Gerstenberg**

1. ‘When a company has consistently been unable to earn the prevailing rate return on its outstanding securities (considering the earnings of similar companies in the same industry and the degree of risk involved), it is said to be over-capitalised.

**Harold Gilbert**

**Meaning of under capitalisation**

In the works of Gerstenberg,”A corporation any be undercapitalized when the rate of

profits, it is making on the total capital is exceptionally high in/relation to the return enjoyed

by similarly situated companies in the same industry or when it has too little capital with

which to conduct its business.

Under-capitalisation is a condition where the real value of company is more than the

book value. The assets do bring profits but is would appear to be much larger than are warranted by book figures of the capital. In such cases, the dividend will naturally be high and the market value of shares will be much higher than par value: It is in the sense that an under-capitalised company pays exceptionally high rates of dividend.

**TOPIC-7**

**CAPITAL STRUCTURE**

**Meaning of Capital structure**

According to Gestenberg, capital structure refers to “the make up of a firms’s capitalization.” In other workds it represents the mix of different sources of long term funds (such as equity shares, preference shares, long tem loans, retained earnings, etc..) in the total capitalization of the company.

For example a company has equity shares of Rs.1,00,000 , debentures Rs.1,00,000 , preference shares of Rs.1,00,000 and retained earnings of RS.50,000. the

Term capitalization is used for long term funds. In this case it is of Rs 350,000/- The term capital structure is used for the mix of capitalization.

In this case it will be said that the capital structure of the company consists of Rs.1,00,000 in equity shares, RS.1,00,000 preference shares, Rs.1,00,000 in debentures, and Rs. 50,000 in retained earnings.

Patterns of capital structure

In case of new company the capital structure may be of any of the following

4 patterns:-

1. Capital structure with equity shares
2. Capital structure with both equity and preference shares.
3. Capital structure with equity shares and debentures
4. Capital structure with equity shares, prefernce shares and debentures.

**FACTORS DETERMINING CAPITAL STRUCTURE**

The capital structure of a company is to be determined initially at the time the company

is floated. Great caution is required at this stage, since the initial capital structure will have

no implications. Of course, it is not possible to an

ideal capital structure but the management should set a target capital structure and the

initialcapital structure should be framed and subsequent changes in the capital structure should

be done keeping view of the target capital structure.

Following are the factors which should be kept in view while determining the capital structure

of a company:-

1. **Trading on equity**

A company may raise funds by issure of shares or by debentures. Debentures

Carry a fixed rate of dividend and this interest has to be paid irrespective of profits.

Of course, preference shares are also entitled to a fixed rate of dividend but payment

Of dividend depends upon the profitability of the company. In case the rate of return

(RoI on the total capital employed is more than the rate of interest on debentures

Or rate of dividend on preference shares, it is said that the company is trading on

Equity.

EXAMPLE

The total capital employed in a company is a sum of Rs.2,00,000. The capital employed

Consists of equity shares of rs.10/- each. The company makes a profit of Rs.30,000 every

Year. In such a case the company cannot pay a dividend of more than 15% on the equity share

Capital.

30,000

-----------x 100

2,00,000

However, if the funds are raised in the following manner, and other things remain the same, the

Company may be in a positon to pay a higher rate of return on equity shareholders funds:

1. Rs. 1,00,000 is raised by issue of debentures, carrying interest @ 10% p.a
2. Rs.50,000 is raised by issue of preference shares, carrying divident at 12%
3. Rs.50,000 is raised by issue of equity shares

In the aforesaid case, out of total profit of Rs.30,000,

* Rs.10,000/- is used for paying interest
* Rs. 6,000/- will be used for paying preference dividends.
* Rs. 14,000/- will be left for paying preference dividends.

Company can give a dividend of 28%.

14,000

-----------x 100

50,000

Thus the company can pay a higher rate of dividend than the general rate of earning of the total capital employed. This is the benefit of trading on equity.

1. **Retaining Control**

The capital structure of a company is also affected by the extent to which the promoter / existing

Management of the company desire to maintain control over the affairs of the company.

1. **Nature of Enterprise**

Business enterprise which have stability in their earnings or which enjoy monopoly regarding

their products may go for debentures or preference shares since they will have adequate

profits to meet the recurring cost of interest / fixed dividend. This is true in case of public

utility concerns.

1. **Legal requirements**

The promoters of the company have also to keep in view the legal requirements while deciding

about the capital structure of the company.

1. **Purpose of financing**

The purpose of financing also to some extent affects the capital structure of the company.

In case funds are required for productive purpose, the company can afford to raise the funds

by issue of debentures.

1. **Period of finance**

In case funds are required for 3 to 10 years, it will be appropriate to raise them by issue

of debentures rather than by issue of shares.

1. **Market sentiments**

The market sentiments also decide the capital structure of the company. There are periods

When people wants to have absolute safety. In such cases, it will be appropriate to raise

funds by issue of debentures.

1. **Requirements of Investors**

In order to collect funds from different categories of investors, it will be appropriate

for the companies to issue different types fo securities and collect their funds from different

sources. They are in a better bargaining position and can get funds from the sources of their

choice.

1. **Size of the company**

Companies which are of small size have to rely considerably upon the owner’s funds for

Financing. Large companies can issue different types of securities and collect their funds from

From different sources. They are in a better bargaining position and can get funds from the

Sources of their choice.

1. **Government Policy**

Govt. Policy is also an important factor in planning the company’s capital structure. For

example, a change in the lending policy of financial institutions may mean a complete

change in the financial pattern. Similarly by virtue of SEBI Act, 1992, the SEBI can considerably

affect the capital issue policies of various companies. Besides this, the monetary and

fiscal policies of the Govt. Also affect the capital structure decision.

1. **Provision for the future**

While planning capital structure the provision for future should also be kept in view. It will

Always be safe to keep the best security to be issued in the last instead of issuing all types

of securities in one installment.

**TOPIC-8**

**WORKING CAPITAL MANAGEMENT**

**Meaning**

Capital required for a business can be classified under two main categories,

Viz.m,

i.Fixed Capital, and

ii.Working Capital

Every business needs funds for two purposes- . for its establishment and to carry out its

Day to day operations. Long term funds are required to create production facilities through

Purchse of fixed assets such as plant machines, land, building, furnitur, etc. Investments

In these assets represent that part of firm’s capital which is blocked on apermanent or fixed

basis and is called fixed capital which is blocked on a permanent or fixed basis and is fixed

capital. Funds are also needed for short term purposes for the purchase of raw material,

payment of wages and other day expenses, etc. These funds are known as working capital,

hi simple works, working capital refers to that part of the firm’s capital which is required for

financing short term or current assets such as cash, marketable securities, debtors and inventories. Funds, tints invested in current assets keep revolving fast and are being1 constantly converted into cash and this cash flows out again in exchange for other current

assets. Hence, it is also known as revolving or circulating capital or short term capital.

In the words of Shubin,” working capital is the amount of funds necessary to cover the cost of running the enterprise.”

According to Genestenberg, “Circulating capital means current assets of a company that are changed in the ordinary course of business from one form to another, as for example, from

Cash to inventories, inventories to receivable, debtors into cash.”

**Concept of Working Capital**

There are two concepts of working capital:

i)Gross Working Capital.

ii)Net Working Capital.

In the broad sense, the term working capital refers to the gross working capital and represents the amount of funds invested in current assets. Thus, the gross working capital is the capital

Invested in total current assets of the enterprise. Current assets are those assets which in the ordinary course of business can be converted into cash within a short period of normally one

Accounting year. Example of current assets:

1. Cash in hand and bank balances.
2. Bills Receivables.
3. Sundry Debtors (less provision for bad debts)
4. Short term loans and advances.
5. Inventories of Stocks, as:
6. Raw materials,
7. Work-in-process,
8. Stores and spares,
9. Finished goods.
10. Temporary Investments of surplus funds.
11. Prepaid Expenses.
12. Accrued Incomes.

In a narrow sense, the term working capital refers to the net working capital. Net working

Capital is the excess of current assets over current liabilities, or say:

Net Working Capital = Current Assets – Current Liabilities

Net working capital may be positive or negative. When the current assets exceed the current liabilities, the working capital is positive and the negative working capital results when

the current liabilities are more than the

current assets. Current liabilities are those liabilities which are intended to be paid in the ordinary course of business within a short of normally one accounting year out of the current

assets or the income of the business.

Examples of current liabilities are;

1. Bills payable,
2. Sundry creditors or Accounts payable
3. Accrued or Outstanding Expenses.
4. Short term loans, advances and deposits
5. Dividends payable.
6. Bank Overdraft.
7. Provision for taxation if it does not amount to appropriation of profits.

The gross working capital concept, is a financial or going concern concept wheras

net working capital concept is an accounting concept of working capital. These two concepts of working capital are not exclusive rather both have their own merits.

**Classification or Kinds fo Working Capital**

Working cpital may be classified in two ways;

1. On the basis of concept.
2. On the basis of time.

On the basis of concept, working capital is calssified as gross working capital and net working capital as discussed earlier. This classification is important from the point of view of the financial manger. On the basis of time, working capital may be classified as:

1. Permanent or fixed working capital.
2. Temporary or variable working capital.

**Working Capital**

Permanent of Fixed Temporary on Variable

Regular Reserve Seasonal Special

1. Permanent of Fixed Working Capital. Permanent or fixed working capital is the minimum amount which is required to ensure effective utilisation of fixed faclities and for maintaining the circulation

of current assets. There is always a minimum level of current assets which is continuosly required by the enterprise to carry out its normal business operations. For example every firm has to maintain a minimum level of raw materials, work in process, finished goods and cash balance. This minimum

level of current assets is called permanent or fixed working capital as this part of capital is permanently blocked in current assets.

**Factors Determining the Working Capital Requirments**

The working capital requirement of a concern depend upon a large number of factors such as nature and size of business, the character of their operations, the length of production cycles, the rate of stock turnover and the state of economic situation. It is not possible to rank them because all such factors are of different importance and the influence of individual factors changes for a firm over time. However, the following are important factors generally influencing the working capital requirements.

1. Nature or Character of Business. The working capital requirments of a firm basically depend upon the nature of its business. Public utility undertakings like Electricity, Water Supply and Railways need very limited working capital because they offer cash sales only and supply services, not

Products, and such no funds are tied up in inventories and receivables. On the other hand, trading and financial firms require a very less investment in fixed assets but have to invest large amounts in current assets like inventories, receivables and cash; as such they need large amount of working capital. The manufacturing undertakings also require sizable working capital along with fixed investments because they have also to build up inventories. Generally speaking, it may be said that public utilitity undertakings require small amount of working capital, and financial firms require small -amount of working-capital, - trading-and financial firms require relatively very large amount, whereas manufacturing undertakings require sizable working capital between these two extremes.

1. **Size of Business/Scales of Operations**. The working capital requirments of a concern are directly influenced by the size of its business which may be measured in terms of scale of operations. Greater the size of a business unit, generally, larger will be the requirments of working capital. However, in some cases, even a smaller concern may need more working capital due to high overhead charges, ineffcient use of available resources and other economic disadvantages of small size.
2. **Production Policy**. In certain industries the demand is subject to wide fluctations due to seasonable variations. The requirments of working capital, in such cases, depend upon the production policy. The production could be kept either steady by accumlating inventories during slack periods with a view to meet high demand during the peak season or the –production could be curtailed during the slack season and increased during the peak season. If the policy is to keep the production steady by accumulating inventories, it will require higher working capital.
3. **Manufacturing Process/Length of Production Cycle**. In manufacturing business, the requirements of working capital increase in direct proportion to the length of manufacturing process. Longer the process period of manufacture, large is the amount of working capital required. The longer the manufacturing time, the raw materials and other supplies have to be carried for a longer period in the processing with progressive increment of labour and service costs are the finished product is finally obtained.. Therefore, if there are alternative processes of production, the process with the shortest production period should be chosen.
4. **Seasonal Variation**. In certain industries, raw material is not available throughout the year. They have to buy raw materials in bulk during the season to ensure an uninterrupted flow and process them during the entire year. A huge amount is, thus blocked in the form of material inventories during such season, which give rise to more working capital requirements. Generally during the busy season, a firm requires larger working capital than in the slack season.
5. **Working Capital Cycle**. In a manufacturing concern, the working capital cycle starts with the purchase of raw material and ends with the realisation of cash from the sale of finfished products. This cycle involves purchase of raw materials and stores, it conversion into stocks of fifnfished goods through work-in-progress with progressive increment of labour and service costs, conversion of finfished stock into sales, debtors and receivables and ultimately realisation of cash and this cycle continues from agian cash to purcahase of raw material and so on.

The speed with which the working capital completes one cycle determines the requirements of working capital-longer the period of the cycle, larger is the requirement of working capital.

Note: the cycle is related to Print No.6.

Cash Cash

gives rise to increse in size, diminishing margin of safety and feeling a sense of trees and train. Thus it is advisable for every company to carry on its business in terms ofthe financial resources it has at its command and not to do more business or excessive trading than what its finances permit.

**7.** **Credit Policy:** The credit policy of a concern in its dealings with debtors and creditors influences considerably the requirements of working capital. A concern that purchases its requirements on credit and sells its products/services on cash requires lesser amount of workingcapital. On the other hand, a concern buying its requirements for cash and allowing credit to its customers, shall need larger amount of working capital as very huge amount of funds are bound to be tied up in debtors or bills receivables.

**8. Business Cycles.** Busines cycle refer to alternate expansion and contraction in general business activity. In a period of boom, i.e., when the business is prosperous, there is a need for larger amount of working capital due to increase in sales, rise in prices, optimistic expansion of business, etc. On the contrary, in the times of depression, i.e., when there is a down swing of the cycle, the business contracts, sales decline, difficulties are faced in collections from debtors and firms may have a large amount of working capital lying idle.

**9.** **Rate of Growth of Business.** The working requirements of concern increase with the growth and expansion of its business activities. Although, it is difficult to determine the relationship between the growth in the volume of business and the growth in the working capital of a business, yet it may be concluded that for normal rate of expansion in the volume of business, we may have retained profits to provide for more working capital but fast growing concerns, we shall require larger amount of working capital.

**10**  **Earning Capacity and Dividend Policy**. Some firms have more earning capacity than others due to quality of their products, monopoly conditions, etc. Such firms with high earning capacity may generate cash profits from operations and contribute to their working capital. The dividend policy of a concern also influences the requirements of its working capatial. A firm that maintains a steady high rate of cash dividend irrespective of its generation of profits needs more working capital than the firm that retains larger part of its profits and does not pay so high rate of cash dividend.

**11**  **Prine Level Changes.** Changes in the price level also affect the working capital requirements. Generally, the rising prices will require the firm to maintain larger amount of working capital as more funds will be required to maintain the same current assets, The effect of rising prices may be different for different firms. Some firms may be affected much while some others may not be affected at all by the rise in prices.

**12**  **Other Factors**. Certain other factors such as operating efficiency, management ability, irregularities of supply, import policy asset structure, importance of labour, banking facilities etc., also asset structure, importance of labour, banking facilities etc., also influences the requirements of working capital.

**OVER TRADING AND UNDER TRADING**

**Over Trading**

In simple words, overtrading means a situation where a company does more business then what its finances allow. It is related to the cash position ofthe enterprise and it occurs when the company expands its scale of operations with insufficient cash resources. The result is disastrous as overtrading.

**Under-trading**

Under-trading is just the opposite of over-trading where the funds of a company are not utilised fully because of inefficient management. Too much amount invested in current assest and too low an amount due to creditors will be symptoms of under-trading. The consequences of under-traiding are reduced profits, low rate of return on investment, decline in the share prices in the share market and evenfully, loss of goodwill.

**Capital Gearing**

The tern refers to the relationship between equity capital (equity shares plus reserves) and long-term debt. It may be planned or historical, the latter describing a state of affairs where the capital structure has evolved over a period of time, but not necessarily in the most advantages way. In simple words, capital gearing means the ratio between the various types of securities in the capital structure of me company. A company is said to be in high-gear, when it has a proportionately higher / larger issue of debentures and preference shares for raising the long term resources, whereas low gear stands for a proportionately large issue of equity shares.

**TOPIC -9**

**BASICS OF CAPITAL BUDGETTING**

**Meaning**

Capital budgerring is the process of making investment decisions in Capital expenditures. A capital expenditure may be defined as an expenditure the benefits of which are expected to be received over a period of time exceeding one year. The main characteristic of a capital expenditure\*, is that the expenditure is incurred at one point of time whereas benefits of the expenditure are realised at different points of time in future. In simple language we may say that a capital expenditure “is an expenditure incurred for acquiring or improving the fixed assets, the benefits of which are^ expected to be received over a number of years in future.

Example of Capital expenditure

1. Cost of acquisition of permanent assets such as land and building, plant &machinery, goodwill etc.
2. Cost of addition, expansion, improvement or alternation in the fixed asset.
3. Cost of replacement of permanent assets.
4. Rsearch and developmenmt project cost etc.

Capital budgeting is also known as Investment Decision making capital expenditutre Decision.

Planning capital Expenditure and Analysis of Capital Expenditure

Definitions

Charles T.Homgreen has defined capital budgetin as “capital budgeting is long term planning 14 for making and financing proposed capital outlays”

According to G.C Philippatos’ capital budgeting is concerned with the allocation of the

firm’s scarce financial resources among the available market opportunities. The consideration of investment opportunities involves the comparison of the expected future streams of earnigs from a project, with the immediate and subsequent streams of expenditure for it”

Richard and Greenlaw have referred to capital budgeting as “acquiring inputs with long run return .“

In the words of Lynch ‘capital budgeting consists in planning development of available capital for the purpose of maximising the long term profitably of the concern”.

**Need and Importance of capital budgeting**

Capital budgeting means planning for capital assets. These are vita! To any organisation as,, they include the decisions to:-

1. sWhether or not funds should be invested in long term projects such as setting of an industry, purchase of plant & machinery.
2. Analyse the proposal for expansion or creating additional capacities
3. To decide the replacement of permanent asset such as building and equipments.
4. To make financial analysis of various proposals regarding capital investments as to choose the best out of many alternative proposals.

**Methods of capital budgeting/ Evalution of Investment Proposals**

At each point of time a business firm has number of proposals regarding various projects in which it can invest funds. But the funds available with the firm are always limited and it is not possible to invest funds in all the proposals at a time. The curx of the capital budgeting is the allocation of available resources to various proposals. Ther are influence the capital budgeting decisions. The crucial facts that influences the capita budgeting decision is the profitability of the prospective investment. Yet the risk involved in the poposal cannot be ingnored because profitability and risks involved in the proposal cannot be ignored because profitability and risks are directly related ie, higher the profitably the greater risk and vice vera.

The various commonly used methods, of capital budgeting are as follows:-

**a. Traditional methods/ Non Discounted methods**

1. Pay Back period Method/Pay out/pay off Method

2. Rate of return Method/Accounting method

**b. Time-adjusted methods or Discounted Methods**

3.Net present value Method

4. Internal Rate of Return Method

5. Profitability Index Method.

**TRADITIONAL METHODS**

**Pay back period method**

This method is based on the principle that every capital expenditure pays itself back within a certain period, out of the additional earnings generate from the capital assets. Payback period is defined as “the number of years required to recover the original capital outlay invested in a project. If the project generates constant annual cash inflow, the payback period can be computed by dividing cash outlay by the annual cash inflow.

Cash out lay (investments)

Pay back period =

Annual Cash inflow

**1. Acceptance Rule**

This can be used as an accept reject criterion as well as a method of ranking projects.

If the payback period calculated for a project is less than the maximum payback period set up J by management, it would be accepted, if not it would be rejected.

As a ranking method it gives highest ranking to the project which has shortest payback period and lowest ranking to the project with highest payback period.

**2. Accounting Rate of Return method**

The accounting rate of return (ARR) method uses accounting informations, as revealed by financial statements, to measure the profitability of the investment proposals:-

The accounting rate of return is found by dividing the average income after taxes by the average investment. The average investment would be equal to the original investment plus salvage\* value(if any) divided by two.

Average income

ARR = x 100

Average investment

**Acceptance Rule**

As an accept-or reject criterion, this method will accept all project whose ARR is higher than the minimum, established by management-add reject those projects which have ARR less than; minimum rate. This method would rand a project as number one If it has highest ARR and lowest rank wuld be assigned to the project with lowest ARR.

**DISCOUNTED CASH FLOW METHODS**

The traditional methods are not theoretically sound. One great limitation is their inability to consider the timing of cash flows. The payback period method consider all cash flows received before the payback period equal, and all cash flows’ received after the payback period are ignored completely.

The ARR method on the other hand related cash proceeds to the original or average cost of the investment. Thus both methods fail to recognise the time value of money in evaluating the invetment worth of the project.

DCF mehotds fully recognise the timing of cash flows into analysis. These two methods are the net present value method and the internal rate of return method. A third method the cost – benefits ratio or profitably index is a variation of the net present value method. As a group these, methods could be called the time-adjusted or discounted cash flow or project value methods

**NET PRESENT VALUE METHOD**

The net present value (NPV) method is the classic economic method of evaluating the investment proposals. It is one of the discounted cash flow (DCF) techniques explicitly recognising the time value of money. It correctly postulates that cash flows arising at different time periods differ in value and are comparable only when their equivalents- present values-are found out. The steps involved in the NPV mehod are: *First,*an appropriate rate of interest should be selected to discount cah flows. Generally, the appropriate rate of interest is the firm’s *cost of capital* which is equal to the minimum rate of return expected by the investors to be earned by the firm on its investment proposal *second* the present value of investment proceeds (ie., cash inflows) and the present value of investment outlay (i.e., cash outflow) should be computed using cost of capital as the discounting rate. If all cash outflow are made in the initial year, then their present value will be equal to the amount of cash actually spent, *Third*, the net present value should be found out by subtracting the present value of cash outflows from the present value of cash inflows, thus, *the NPV method is a process of calculating the present value of cash in flows (inflows and outflows) of an investment*  **.** prosposal, using the cost of capital as the appropriate discounting rate, and finding out the net present value by subtracting the present value of cah outflows from the present value of cash inflows.

The equation for the net present value, assuming that all cash outflows are made in the intial year (to) will be:

NPV= ---------- ----------- ---------- -----------

----------------

Where A1.A2 represent cash finflows, *k* is the firm’s cost of capital C is the cost of the investment proposal and n is the expected life of the proposal. It should be noted that the cost of capital k, is assumed to be known otherwise the net present value cannot be calculated.

**INTERNAL RATE OF RETURN METHOD**

The internal rate of return (IRR) method is another discounted cash flow technique which takes account of the magnitude and timing of cash flows. The use of this method for appraising the investment projects was emphasised in informal terms, for the first time, by Joel Dean... Other terms used to describe the IRR method are yield of an investment, marginal efficiency of capital, rate of return over cost, time adjusted rate of return etc.

The internal rate of return can be defined as that rate which equates the present value of call inflows with the present value of cash outflows of an investment. In other words, it is the rate at which the net present value fo the investment is zero.It is called internal rate because it depends solely on the outlay and proceeds associated with the project and not any rate determined outside the investment. It can be determined by solving the following equation.

NPV= ----------- ----------- ----------- -----------

C= -----------

It can be noticed that the IRR equation is the same as used for the NPV method with the difference that in the NPV mehod the required rate of interst (cost of capital),\*is assumed to be known and the net present value is found, while under the IRR method the value of has to be determined at which the net which the net present value if zero.

**Acceptance Rule**

The accept-or-reject rule, using the IRR mehod, is to accept the project if its internal rate of return is higher than or equal to die minimum required rate of return (i.e..i>k), which is also known as the firm’s cost of capital or the outoff,or hurdle, rate. The project shall be rejected if its internal rate of return is lower than the cost of capital (i.e, r<k).

**PROFITABILITY INDEX**

Yet another time-adjusted method of evaluating the investment proposals is the benefit-Cost (B/C ratio or profitability index (PI). It is the ratio of the present value of future cah benefits, at the required rate of return to the initial cash , outflow of the invetment. It may be gross or

net, net beign simply gross minus one. The formula to calculate benefit cost ratio or profitability index is as follows:

ARR= PV of Cash inflows

Initial Cash Outlay

**Evaluation of Profitability Index**

Like the NPV and Irr method, PI is a conceptually sound method of appraising investment projects. It gives due consideration to the time value of money. Administratively, it requires more computaion than the traditional method but less than the IRR method. Projects can be ranked in accordance with their. PI. Highest rank will be given to the project with highest PI, while lowest rank will be assigned to the project having lowest PI. This method can also be used to choose between matually exclusive projects by calculating the incremental benefit-cost ratio.

**CAPITAL BUDGETING**

**EQUATIONS AT A GLANCE**

|  |  |  |  |
| --- | --- | --- | --- |
| Sl.  No | Method | Equations | Accept/reject rule |
| 1 | Pay back period | Initial investment  Annual Cash inflow | Lowest payback period will be selected |
| 2 | Average Rate of Return | Average Annual profit  Average investment | Highet ARR% is selected |
| 3 | Net present Value | Present Value of Cash inflow---Investment | Positive NPV is accepted |
| 4 | Profitability index | Present value of cash inflow  initial investment | Above 1 is selected |

**PROBLEM:1**

**SIMPLE PROBLEMS**

**PAY BACK PERIOD**

A project costs Rs. 1,00,000 and yields an annual cash inflow of Rs.20,000 for 8 years. Calculate its Pay Back Period.

**PROBLEM:2**

Determine the Pay-Back Period for a project which requires a cash outlay of Rs. 10,000 and generates cash inflows of Rs. 2,000, Rs.4,000, Rs.3,000 and Rs. 2,000 in the first, second, third and fourth years respectively.

**PROBLEM:3**

A project cost Rs.5,00,000 and yields annually a profit of Rs.80,000 after depreciation @ 12% p.a. but before tax of 50%. Calculate the Pay-Back period.

**PROBLEM:4**

There are two projects X and Y, Each Project requires and investment of Rs.20,000 you and are required to rank those Project according to the Pay-Back Period method from the following information.

**(Net Profit before depreciation after tax)**

|  |  |  |
| --- | --- | --- |
| Year | Project X (Rs.) | Project Y (Rs.) |
| 1st | 1000 | 2000 |
| 2nd | 2000 | 4000 |
| 3rd | 4000 | 6000 |
| 4th | 5000 | 8000 |
| 5th | 8000 | --------- |

**ARR Method**

**PROBLEM :5**

A Project requires an investment of Rs.50,00000 and has a scrap value of Rs. 20000 after 5 years. It is expected to yield profit after depreciation and taxes during the five years amounting to Rs.40000, Rs.60000, Rs.70000,Rs 50000 and Rs, 20,000.

Calculate Average Rate of Return

**PROBLEM: 6**

A Project requires an investment of Rs.500000 and has a scrap value of Rs.20000 affter 5 years. It is expected to yield profit after depreciation and taxes during the five years amounting to Rs.40000, Rs.60000, Rs.70000, Rs.50000 and Rs20000.

Calculate the Average Rate of Return on the investment.

**PROBLEM :7**

A Project costs Rs 50000 and has a scrap value of Rs.10000, Its stream of income before depreciation and taxes during first year through five years is Rs.10000, Rs. 12000. Rs,14000 Rs,16000 and Rs20000. Assume a 50 percent tax rate basis. Calculate the Accounting Rate of Return for the project.

**NPV : Method**

**PROBLEM :8**

Calculate the NPV for Project X, which initially costs Rs.2500 and generates year end cash inflows of Rs.900, Rs 800,Rs.700, Rs,600, Rs500, in one through five years. The required rate of return is assumed to be 10 percent.

|  |  |
| --- | --- |
| Year | PV factor @ 10% |
| 1 | .909 |
| 2 | .826 |
| 3 | .751 |
| 4 | .683 |
| 5 | .621 |

**PROFITABILITY INDEX METHOD**

**PROBLEM :9**

|  |  |
| --- | --- |
| Year | PV factor @ 10% |
| 1 | .909 |
| 2 | .826 |
| 3 | .751 |
| 4 | .683 |

The intitial cash outlay of a project is Rs.100000 and it generates cash inflows of Rs.40000. Rs.30000, Rs.50000 and Rs.20000. Calculate NPV and PI of the Project. Assume a 10 percent discount.

**PROBLEM :10**

Rank the following projects in order of their desirability according to the pay back period Method are the Net Present Value Index Method.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Project | Initial outlay  (Rs) | Annual cash flow  (Rs) | Life in year | PV factor @ 10% |
| A | 10,000 | 2,500 | 5 | 3.791 |
| B | 8,000 | 2,600 | 7 | 4.868 |
| C | 4,000 | 1,000 | 15 | 7.606 |
| D | 10,000 | 2,400 | 20 | 8.514 |
| E | 5,000 | 1,125 | 15 | 7.606 |
| F | 6,000 | 2,400 | 6 | 4.355 |
| G | 2,000 | 1,000 | 2 | 1.736 |

(TEE-2009)

**PROBLEM :11**

Calculate the Average Rate of Return for Projects A & B from the following

|  |  |  |
| --- | --- | --- |
|  | Project A | Project B  (Rs) |
| Investment | Rs.20,000 | 30,000 |
| Expected life  (No salvage value) | 4 years | 5 years |

Projected Net Income (after interest, depreciation and taxes)

|  |  |  |
| --- | --- | --- |
| Year | Project A  (Rs) | Project B  (Rs) |
| 1 | 2000 | 3000 |
| 2 | 1500 | 3000 |
| 3 | 1500 | 2000 |
| 4 | 1000 | 1000 |
| 5 | ---- | 1000 |
|  | 6000 | 10000 |

If the required rate of return is 12% which project should be undertaken.

**PROBLEM :12**

The Alpha company Ltd is considering the purchase of a new machine. Two alternative machine (A and B) have been suggested costing Rs. 4,00,000. Earnings after taxation are expected to be as follows.

|  |  |  |
| --- | --- | --- |
| Year | Machine A  Rs | Machine B  Rs |
| 1 | 40,000 | 1,20,000 |
| 2 | 1,20,000 | 1,60,000 |
| 3 | 1,60,000 | 2,00,000 |
| 4 | 2,40,000 | 1,20,000 |
| 5 | 1,60,000 | 80,000 |

The company has a target of retun on capital of 10% and on this basis, you are requred to compare the profitabilityu of the machines and state which machine you consider financially preferable.

Note :- The present value of Re.1

@ 10% due in

|  |  |
| --- | --- |
| 1 year | 0.91 |
| 2 year | 0.83 |
| 3 year | 0.75 |
| 4 year | 0.68 |
| 5 year | 0.62 |

**PROBLEM :13**

A company has an investement opportunity costing Rs.40,000 with the following expected net cash flow after taxes and before depreciations.

|  |  |
| --- | --- |
| Year  Rs | Net cash flow  Rs |
| 1 | 7,000 |
| 2 | 7,000 |
| 3 | 7,000 |
| 4 | 7,000 |
| 5 | 7,000 |
| 6 | 8,000 |
| 7 | 10,000 |
| 8 | 15,000 |
| 9 | 10,000 |
| 10 | 4,000 |

Using 10% as the cost of capital detetrmine the following.

1. Pay back period
2. Net present value at 10% discount factor
3. Profitability Index 10% discount factor
4. Internal rate of return with the help of 10% and 15% discount factor.

Note:-

|  |  |  |
| --- | --- | --- |
| Year | Present value of Re.1/- at 10% discount rate | Present value of Re.1/- at 15% discount rate |
| 1 | 0.909 | 0.870 |
| 2 | 0.826 | 0.756 |
| 3 | 0.751 | 0.658 |
| 4 | 0.683 | 0.572 |
| 5 | 0.621 | 0.497 |
| 6 | 0.564 | 0.432 |
| 7 | 0.513 | 0.376 |
| 8 | 0.467 | 0.327 |
| 9 | 0.524 | 0.284 |
| 10 | 0.386 | 0.247 |

(TEE, 2000)

**PROBLEM :14**

From the following information calculate the net present value of the two projects and suggest which of the two projects should be accepted assuming a discount rate of 10%

|  |  |  |
| --- | --- | --- |
|  | Project X (Rs) | Project Y (Rs) |
| Initial Investment | 20,000 | 30,000 |
| Estimated Life | 5 years | 5 years |
| Scrap Value | 1,000 | 2,000 |

The profit before depreciation and after taxes (cash flows ) are as follows

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | Year-1 | Year-2 | Year-3 | Year-4 | Year-5 |
| Project X (Rs) | 5,000 | 10,000 | 10,000 | 3,000 | 2,000 |
| ProjectY (Rs) | 20,000 | 10,000 | 5,000 | 3,000 | 2,000 |

Present value of Re.1/- payable or receivable at the rate of 10% discount factor:

|  |  |
| --- | --- |
| Year | 10% |
| 01 | 0.909 |
| 02 | 0.826 |
| 03 | 0.751 |
| 04 | 0.683 |
| 05 | 0.621 |

(TEE, 2001)

**PROBLEM : 15**

A Restaurant proposalsfor to mutually exclusive projects invoving initial investment of Rs. 20,000/- in both the cases, but the cases, but with varying cash flows during the future periods given as under:

|  |  |  |
| --- | --- | --- |
| Year | Cash | Inflows |
|  | (Projects A Rs.) | (Projects Rs.) |
| 1 | 4,000.00 | 8,000.00 |
| 2 | 4,000.00 | 6,000.00 |
| 3 | 4,000.00 | 2,000.00 |
| 4 | 8,000.00 | 2,000.00 |
| 5 | 2,000.00 | 2,000.00 |
| 6 | --- | 2,000.00 |
| 7 | --- | 2,000.00 |
| 8 | --- | 2,000.00 |

Applying 7% as the discount rate, you are required to determine which project should be taken up according to Net Present Value method of investment Appraisal.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Year | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| Present  Value of  Re.1/-  (at 7%  Discount  Rate) | 0.935 | 0.873 | 0.816 | 0.763 | 0.713 | 0.666 | 0.623 | 0.582 |

**(TEE 2002)**

**PROBLEM : 16**

A company is planning to purchase a machine. Two machines are available X & Y, each costing Rs. 50,000/-. Earnings after taxation are expected as follows:

|  |  |  |
| --- | --- | --- |
| Year | CASH FLOW | |
| MACHINE X (in rupees) | MACHINE Y (in rupees) |
| 1 | 15,000 | 5,000 |
| 2 | 20,000 | 15,000 |
| 3 | 25,000 | 20,000 |
| 4 | 15,000 | 30,000 |
| 5 | 10,000 | 20,000 |

Evaluate the two alternative according:

(a) The Pay – back period method

(b) Net present value method

Apply 10% as the discount rate

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Year | 1 | 2 | 3 | 4 | 5 |
| Present value of Re. 1/- at 10%  discount rate | 0.909 | 0.826 | 0.751 | 0.683 | 0.621 |

**TEE 2004**

**PROBLEM : 17**

From the following information calculate the net present value of the two projects and suggest which of the two projects should be accepted assuming a discount rate of 10%.

|  |  |  |
| --- | --- | --- |
|  | Project I (Rs.) | Project II (Rs.) |
| Initial Investment | 40,000 | 60,000 |
| Scrap Value | 2,000 | 4,000 |
| Estimated Life | 5 years | 5 years |

The cash flows ae as follows

|  |  |  |
| --- | --- | --- |
| Year | Project I (Rs.) | Project II (Rs.) |
| 1 | 10,000 | 40,000 |
| 2 | 20,000 | 20,000 |
| 3 | 20,000 | 10,000 |
| 4 | 6,000 | 6,000 |
| 5 | 4,000 | 4,000 |

Present value of Rs. 1/- @ 10% discount factor

|  |  |
| --- | --- |
| Year | Present Value of Rs. 1/- |
| 01 | 0.909 |
| 02 | 0.826 |
| 03 | 0.751 |
| 04 | 0.683 |
| 05 | 0.621 |

(**TEE 2005)**

**PROBLEM : 18**

A restaurant has a proposal for investment in assets of Rs. 20,000/- the future cash inflows of which are as under:-

|  |  |
| --- | --- |
| Year | Rs. |
| 01 | 6,000 |
| 02 | 4,000 |
| 03 | 4,000 |
| 04 | 4,000 |
| 05 | 3,000 |

Applying 7% as the discount rate you are required to state the viability of the project under NPV method. The PV of the Rs.1/- as 7% discount rate for 5 years is as under;

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Year | 1 | 2 | 3 | 4 | 5 |
| PV of Rs. 1/- @ 7% | 0.935 | 0.873 | 0.816 | 0.763 | 0.713 |

**(TEE 2005 & 2009)**

**PROBLEM : 19**

A hotel has two mutually exclusive project proposals invoving an initial investment of Rs. 1,50,000/- each. The expected net cash benefit from them for the period of their usagde is as given below:

|  |  |  |
| --- | --- | --- |
| Year | Cash inflows | |
| Project A  Rs. | Project B  Rs. |
| 1 | 30,000 | 50,000 |
| 2 | 30,000 | 40,000 |
| 3 | 40,000 | 25,000 |
| 4 | 50,000 | 25,000 |
| 5 | 25,000 | 25,000 |
| 6 | -- | 25,000 |
| 7 | -- | 25,000 |

Applying 8% as the discount rate, you ae required to determine which project should be taken up according to NPV method of investment Appraisal.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Year | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| Present value of Re.1  (at 8% Discount rate) | 0.926 | 0.857 | 0.794 | 0.735 | 0.681 | 0.63 | 0.583 |

**(TEE 2006**)

**PROBLEM : 20**

“ Royal Meredien” Hotel is considering the purchase ofnew kitchen equipment for Rs. 6,00,000. It has as life of four years and an estimated salvage value of Rs. 1,00,000. The equipment will generate an extra per year. The cost of capital is 20% and the tax rate is 50% should the machine be acquire?

(PV factor @ 20%)

|  |  |
| --- | --- |
| Year | Rs. |
| 1st year | 0.833 |
| 2st year | 0.694 |
| 3st year | 0.579 |
| 4styear | 0.482 |
| 5st year | 0.482 |

**(TEE 2005)**

**PROBLEM : 21**

Management of “Blue Star” Hotel is contemplating to buy an equipment for its use. There are presently two equipment available in the market which could serve the purpose. Details about the two equipment are set out below.

|  |  |  |
| --- | --- | --- |
|  | Machinery A  (Rs.) | Machinery B  (Rs.) |
| Cost | 30,000 | 30,000 |
| Annual income estimated after Depreciation and tax | | |
| 1styear | 5,500 | 6,700 |
| 2styear | 8,000 | 7,200 |
| 3rdyear | 8,400 | 8,500 |
| 4thyear | 8,800 | 7,000 |
| 5thyear | 9,000 | 8,800 |
| Estimated lifein years | 5 | 5 |
| Average income tax rate | 55% | 55% |

Depreciation is on straight line basis. Which machine should be the management buy? Assume that the management uses accounting rate of return for the project.

**(TEE 2005)**

**PROBLEM : 22**

The initial cash outlayof a proposed project is Rs. 5,000, 000/-. The cash inflow due next five years are Rs. 1,85,000/-, Rs. 1,25,000/- Rs.1,40, 000/- Rs. 1,70,000/- Rs. 1,80,000/-. Find out the payback period of the project.

**(TEE 2006 & 2008)**

**PROBLEM:23**

A Hotel is planning to introduce mechanized laundry system for which initial investment required is Rs. 3,00,000/-. Using IRR (Internal rate of return) method, find out whether it is feasible to accept at the current rate of interest 10%. The net cash flow after tax is given below:-

|  |  |
| --- | --- |
| Year | Cash inflow (Rs.) |
| 1 | 40,000 |
| 2 | 70,000 |
| 3 | 90,000 |
| 4 | 1,20,000 |
| 5 | 1,20,000 |
| 6 | 1,00,000 |
| 7 | 80,000 |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Year | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 10% | 0.909 | 0.826 | 0.751 | 0.683 | 0.621 | 0.564 | 0.513 |
| 15% | 0.870 | 0.756 | 0.658 | 0.572 | 0.497 | 0.432 | 0.376 |

**(TEE 2006**)

**PROBLEM : 24**

An industrialist is offered tow options for investment with the following cash flows. His decision criterion is a pay back period of three years.

|  |  |  |
| --- | --- | --- |
| Investment required | Investment A | Investment B |
| Annual cash flows | 8,000 | 7,000 |
| Year |  |  |
| 1 | 4,000 | 2,500 |
| 2 | 3,000 | 2,500 |
| 3 | 2,000 | 2,500 |
| 4 | 1,000 | 2,500 |

Advise the industrialist by pay back period.

**(TEE-2010)**

**PROBLEM : 25**

AB Co Ltd is considering to purchase a machine. Two machines are available X and Y costing Rs. 180,000/-

|  |  |  |  |
| --- | --- | --- | --- |
| Year | X machine  Cash inflow | Y machine  Cash inflow | Discount factor  8% |
| 1 | 30,000 | 60,000 | .926 |
| 2 | 50,000 | 1,00,000 | .857 |
| 3 | 60,000 | 65,000 | .794 |
| 4 | 65,000 | 45,000 | .735 |
| 5 | 40,000 | -------- | .651 |
| 6 | 30,000 | --------------- | .630 |
| 7 | 16,000 | -------- | .583 |

Evaluate the two alternative according to Net Present Value method ( Cost of capital @ 8%)

**(TEE-2010)**

**PROBLEM: 26**

A hotel is thinking of automating their launtry services. It requires an initial investment of Rs.1,00,000/-,Scrap value will be Rs. 5,000/-. The life of the asset is 5 years and the cash inflow for the first 2 years Rs. 40,000/- each and 3rd and 4th year 30,000/- each. 5th year it will be Rs. 20,000/-. The cost of capital is 10%.

Advise them whether the investment is desirable using NPV method

(P V factor @ 10% 1) .909 2) .826 3) .751 4) .683 5) .621

**(TEE-2003)**

**NCHMCT EXAM**

**QUESTION**

**PAPER**

**(Only Therory Questions)**

**2002-2010**

**ANNUAL EXAMINATION – 2002**

EXAMINATION PAPER : 3RD YEAR OF 3-YEAR DIPLOMA COURSE

SUBJECT : FINANCIAL MANAGEMENT

Q.1. (a) What is meant by Financial Management? What is its scope?

(b) “The profit maximization is not an operationally feasible

Criterion”. Do you agree? Illustrate your views.

OR

What do you understand by Financial Statement Analysis? What are the different

techniques of such analysis ? Explain in full details.

Q.2. Give short answers to the following questions:

(a) What is working capial ? What are its sources?

(b) What are the uses of Fund Flow Statement?

(c) What are the limitations of Ratio Analysis?

(d) What is the importance of Capital Budgeting?

OR

Write short notes on any four of the following:

(a) Internal Rate of Return

(b) Flexible Budget

(c) Over Capitalisation

(d) Fund from operation

(e) Return on capital employed

(f) Payback period

**ANNUAL EXAMINATION- 2003**

Q1. Discuss the importance of Liquidity and Profitability for the survival of business.

Q2. What statutory statements aremade at the end of the year from the books of accounts?

To whom are they useful and how?

Q3. Write short answer to any four of the following

1. Overtrading
2. Importance of Capital Budgeting
3. DCF technique
4. Flexible Budget
5. Payback period
6. Over Capitalising
7. Du pont control Chart
8. Trading on Equity

Q4. State whether the following statements are True of False:

1. Projects with positive NPV result should be accepted
2. Financial Planning involves scheduling and sourcing of funds also
3. Working capital need is higher where Debtors’ Turnover Ratio is high and Creditors’ Turnover Ratio is low.
4. In a case where rate of return on investment is expected to be high, it is suggested to have more of Debt Capital when compared to Equity Capital
5. Provision for depreciation on Machinery and Equipment would resut in outflow of Cash.
6. A Current Ratio less than 1 means that funding of fixed Assets was done by Current Liabilities
7. A firm with higher margin of safety with early break-even point is not advised
8. For off-hand short-term financial requirements, the best source would be Bank Overdraft.

Q5. Point out the factors that determine the Working Capital needs

SUPPLEMENTARY EXAMINATION – 2003

Q1. What are the limitations of financial Statements?

State the advantages of Ratio analysis

Q2. What are the advantages of cash flow statement.

OR

State the factors that will affect the working capital management.

Q3. Explain in term capital structure. List any five factors that determine the capital structure of the company.

OR

Q4. Explain the term capital structure. List any five factors that determine the capital

structure of the company.

OR

Write short notes on the following (answer should not exceed one page)

i) Under capitalization ii) Financial Planning

Q5. (a) What you mean by Financial Management and Financial Plan?

(b) Give the objectives of Financial Management.

(c) What are the characteristics of a good Financial Plan?

ANNUAL EXAMINATION – 2003

Q1. Explain any five of the following:

(a) Statutory Statements

(b) Capital Budgeting

(c) Financial Planning

(d) Reserves & Surplus

(e) Mortage

(f) Capital Structure

(g) Profitability Ratio

Q2. What is Budgeting? Why it is so important to management? What are its essential

features?

Q3. (a) Explain the term Cash Budget and Cash Flow Statement.

(b) Draw format of Cash Budget with imaginary figures.

Q4. Differentiate between any two of the following

(a) Under Capitalisation and ovr capitalization

(b) Cash flow statement and funds Flow statement

(c) Profit maximization and Wealth maximization

**SUPPLEMENTARY EXAMINATION – 2003**

Q1. Explain how proper internal control can be exercised in front office department of a 5-

Star Hotel.

Q2. Distinguish between Fund flow statement and Balance Sheet

Q3. Define financial management. Explain the functions of a finance executive of a5-Star

Hotel

Q4. What is meant by “ Job Analysis”. Elucidate the importance and the methodology of Job

Analysis. Explain how job analysis helps you to design jobs.

Q5. Write short notes on (any five):

A) Blake & Mouton’s Management Grid

B) Time & Motion Studies

C) Guest Relations

D) Profile of a Manager

E) Job Specifications

F) Behaviorally Anchored Rating Scale (BARS)

G) Collective Bargaining

Q6. Define the following Management Terms

1. Administer

2. Break even point

3. Capital

4. Carrying Costs

5. Decentralization

6. Dividend

7. Extrapolation

8. Lead Time

9. Marginal Cost

10. Productivity

Q7. Prepare an Induction Programme for a group of management Trainees joining your Hotel shortly. Your hotel is a Three Star Category Hotel and you have recruited hyour trainees through campus interviews from Institutes of Hotel Management

**TERM END EXAMINATION – 2003**

Q.1. (a) Explain the “Interpersonal” “Informational” and “decisional” roles of a Hotel

manager.

(b) As a line-manager, how would you prepare an Induction programme for an

employee recently promoted to a supervisory level to prepare him to discharge his

roles. The following dimensions may be kept in mind while uroparing the profile of

the induction programme.

Supervisor as

- a disturbance handler

- a resource allocator

- an en t rapreneur

- a negotiator

(c) State with reasons whether the following statements ‘are “true or false”:

(i) By virtue of the formal authority vested in a manager he must attend as Tar as

possible to all employee functions; functions organised in the community and all

major functions of the city.

(ii) It is alright for a General Manager to receive information from various sources but

passing on important business related information in the employees will dilute his

authority.

(iii) A new idea submitted by a govt. Employees for reducing food costs should not be

encouraged by the Geneal Manager as it is likely to hurt the feelings of the senior

employees.

(iv) A General Manager should always be

(vi) Discuss the comparative advantags and disadvantages of solo ownershi,

partnership and Joint stock companies,

(vii) As proprietor of a partnership firm, which operats a liO room down town hotel, you

are seeking a germ loan from appropriate financial Institutions to add another 10,

rooms to your property – to meet the increasing demand for hotel rooms during the

Visit India Year:

Make out a case, using appropriate ratios, to show the operational and financial health

of your firm to enable you procure loans from the F.L.’s.

(You may use Imaginary data)

(c) State whether the following statements are true or false.:

(I) The higher the room occupancy the higher the Average room rate.

(II) Current ratio expresses a relationship between current assets and total liabilities,

(III) liquidity ratio is an indication of a bank balance of a company.

(iv) A room occupany percentage is ‘he same thng as ahouse count.

(v) A bed occupancy ratio is a better indicator of capacity utilization than room

occupancy ratio.

Q3. You are hired as a project-co-ordinator for a property scheduled to be opened shorlty, witha primay responsibility of establishing and maintain standards In the company. Using the following guidelines briefly outline their relative Importance In the maintenance of standards.

(i) Company policies and procedures

(ii) Recruitment and Training Policies

(iii) Material and requipments

(b) Write short notes on:- (any three)

(a) Policy and Procedures

(b) Methods of forecasting

(c) Planning cycle

(d) Operations Budgets

(e) Controls

(c) Distinguish between: (any two)

(a) Programmed in unprogrammed

(b) Rules and Policies / procedures

(c) Job specification & Job description

(d) Recruitment and Detection

(e) Training and Coaching

Q4. List atleast three key areas you would use from the performance appraisal records in the following situations:

(a) To promote a sous chef to the position of executive chef:

The executive chef is retiring in three months time.

(b) To select a unit manager from amongst the department heads for a small property

being promoted by the company

(c) To replace a cashier who has been discussed from

amongst the bill clerks

Q5. Distinguish between:

(a) Advertisement & publicity

(b) Public relations and guest relations

(c) Merchandising and internal selling

(d) Profits and Profitability

**TERM END EXAMINATIONS – 2006**

Q.1. “Financial Management is that managerial activity which is concerned with the planning and controlling of the firm’s financial resources”. In the light f above definition discuss the scope and extent of Financial Management.

OR

“Financial Management draws heavily on related disciplines and fields of study such as economics, accounting,marketing, productrion and quantitative methods. Discuss.

Q.2. What is meant by the term Ratio Analysis in Financial Management?

Classify the different types of Ratios with examples.

OR

Distinguish between Fund Flow and Cash Flow statements.

Q.3. Briefly describe the techniques of Financial analysis and state the limitations of Financial Analysis.

OR

Define what is meant by Working Capital. Discuss this factors which determine Working Capital needs.

Q.4. State what is meant by the term capitalization. Discuss in the light of this the status of over-capitalisation and under-capitalisation.

OR

Define the term Capital Structure. Discuss the factors that determine Capital Structure of a company.

Q.5. Write short notes on any two of the following:

(a) Internal Rate of Return (b) Overtrading

(c) Wealth maximization objective (d) Acid test ratio

Q.6. Define any five of the following terms:

(a) Business Finance (b) Du – Pent control chart

(c) Fund from operation (d) Financial Plan

(e) Gross Working Capital (f) Pay back period

(g) Rate of Return on capital employed (h) Common size Statement

**SUPPLYMENTARY EXAMINATIONS—2005**

Q.1. Explain briefly differetn tools of finanancial analysis.

OR

What are the limitaitons of Ratio Analysis?

Q.2. A State whethr each of the following statements is true of false:

(a) Purchase of stock-in-trade is an application of funds.

(b)Net profit earned plus non-working capital expenses is equal to use of funds.

(c) A deceased stock turnover ratio usually indicates expanding business

(d) Funds flow statement and cash flow statements are one and the same.

(e) In Pay Back Period method of investment appraisal, the lesser the period, the better it is.

**B.**

Fill in the blanks:

(a) Income statement----------the revenues and costs incurred in the process of earning revenues.

(b) Raio of “Net Sales” to “Net Working Capital” is-------

(c) Depreciation is sometimes treated as --------of funds.

(d) Cash or Credit Sales at a ------- increases the working capital.

(e) cash from, operation is eaual to---------

Q.3. Write short notes on any two of the followiong in not more than 10-15 lines each.

(a) Internal rate of Retrun (b) Financial Planning

(c) Point of Indifference (d) Return on capital employed

Q.4. What do you understand by cost of capital ? Discuss its significance in capital budgeting decision.

OR

Discuss the concept of working capital. What factors should the fincnce manager take into consideraion .

while estimatin working capital needs of a firm?

Q.5. Can provision for taxation be taken as a non-fund item ? Explain

OR

What steps will you take to compute cash from operations ?

Q.6. Differentiate between the following (any two):

a) Under capitalization and over capitalization

b) Profit maximization and wealth maximization

c) Over trading and under trading

SUPPLEMENTARY EXAMINATIONS—2005

Q.1. State whether the following statements are true or fase:

(a) Capital investment is not necessarily an investment in tangible property

(b) Business risk refers primarily to uncertainty about future EBIT, while financial risk refers to the

added uncertainty about future-net income that is caused by the use of debt.

(c) Total current assets is known as net working capital

(d) Financial accounting deals with reporting information for internal use.

(e) Capital structure refers to the mix of long term sources of funds from outsiders and equity and

preference shares from owners.

**Choose the correct answer:**

(f) Which of the following technique will not fall under the category of discounted cash flow method

of investment appraisal?

(i) IRR (ii) ARR (iii) NPV (iv) PI

(g) A firm’s debt-equity ratio is 3:1 and it has total assets of 20 crores. What is the value of equity in

That?

(i) 10 crores (ii) 5 crores (iii) 15 crores (iv) NIL

(h) River View Hotel Ltd. has a sales turnover of Rs. 1,00,000/- Depreciation for the period is Rs

. 20,000/- and other operating expense Rs. 90,000/- Net loss for the period is Rs. 10,000/-. What

is the amount of fund generated from opetration during that period?

(i) Rs. 10,000 (ii) Rs. 20,000/- (iii) Rs. 90,000/- (iv) Zero

(i) Gross profit less administrative, selling and distributive expenses is known as:

(i) Profit before Tax (ii) Net profit (iii) Operating Profit (iv) Profit after tax

(j) which of the following is not an appropriation of Profit?

(i) Distribution to owners (ii) Paying dividend

(iii) Transfers to reserve (iv) Spending for operating expenses

Q.2. Write short notes on any two of the following

(a) Calssification of Assets

(b) Trend analysis

(c) Working capital management

Q.3. What do you understand by financial planning ?

OR

Define various techniques of project appraisal

Q..4 State the determinants of capital structure

OR

What factors a financial manager would ordinarily take, into consideration while estimating working needs of his company.

**TERM END EXAMINATION—2006**

Q. 1. State whether the following statements are True or False:

i) Projects with positive NPV result should be accepted.

ii) Financial Plannning involves schduling and sourcing of funds also

iii) Working capital need is higher where debtros turnover ratio is high and creditors turnover ratio is low

iv) In a case where rate of returnm on investment is expected to be high, it is suggested to have more of debt capital when compared to Equity Capital.

v) Provision for Depreciation on Machinery and Equipment would result in outflow of cash.

vi) A Current Ratio less than 1 means that funding of Fixed Assets was done by Current Liabilities.

vii) A firm with higher margin of safety with early break-even point is not advised.

viii) For off-hand short term financial requiremtns, the best source would be Bank Overdraft.

Q.2 Write short answers to any four of the following:

i) Overtrading

ii) Importance of Capital Budgeting

iii) DCF trechnique

iv) Flexible Budget

v)` payback period

vi) Over capitalizing

vii) Du Pont Control Chart

viii) Trading on Equity

Q.3. Point out the factors the determine the Working Capital needs.

**TERM END EXAMINATIONS---2007**

Q.1.

(a) Define Budget.

(b) Explain meaning and functions of a cash budget.

(c) Discuss the utility of cash budget as tool cash management.

Q.2 . “Working capital is a means and not an end”. Discuss all such factors which exercise influence on the demand for working capital in a business concern.

Q.3. “Financial planning is the key to successful business operations”. Explain and discuss the basic characteristics of a financial plan of a company.

(a) Explain the meaning of funds flow statement

(b) Why do companies prepare a funds flow statement in addition to Balance sheet and income statement?

(c) Can it serve as a substitue for the Balance sheet or income statement?

(d) State four sources (giving examples) from where funds are usually obtained by a business.

(a) Explain the meaning of cash flow statement

(b) Give atleast five points of differnece between funds flow statement and cash flow statement of a firm.

OR

(a) What are the two basic financial statements? Explain.

(b) Explain the purpose of comparison of financial statements

(c) Differentiate between inter-firm comparison and intra-firm comparison

Q.4. (a) Define the scope of financial management

(b) What role should be financial manager play in the modern enterprises.

(c) In what respect is the objective of wealth maximization superior to the profit maximization objective.

Q.5. State whether each of the following statemtnts is true or false:

a) Return on investment helps in determining the overall profitability of a company.

b) Working capital is the difference between fixed assets and current assets.

c) Funds flow refers to chagers in working capital.

d) The income statement discloses the factors responsible for chagers in the financial conditon of business.

e) Marshalling of Assets & Liabilities is a term used in context of the statement profit and loss account.

f) The terms ‘ analysis’ and ‘interpretation’ for financial statements are independent of each other.

g) There is no differnece betwen a budget and a forecast.

h) Excess capital is good for a sound fianancial plan.

i) Non-trading income are not taxable income.

j) Capitalisation, capital structure and financial structure mean the same.

**SUPPLEMENTARY EXAMINATION--2007**

Q.1. “ The profit maximization is not an operationally feasible criterion” Do you agree ? illusttrate you views.

OR

Q.2 What is meant by Ratio Analysis in financial management ? Explain profitability ratios with examples.

OR

Q.3. What is Profit maximization and wealth maximization?

Q.4. What is meant by Financial management ? What is its scope?

OR

What do you mean by Business Finance ? How is it improtant for an organization ?

Q.5. Explain the following with example.

(a) Revenue (b) Short-term Liability (c) Reserve

(d) Expenses (e) Stock

Q.6. Differentiate between any two of the following:

(a) Fund Flow and Cash Flow

(b) Business Finance and Financial Statement.

(c) Reserve and Profit

Q.7. Explain Capital Structure and mention the factors affecting capital structure.

Q.8. What is meant by Working Capital and the factors which detetrmine the working capital needs?

Q.9. Define Undercapitalization and how is it different from Over capitalization.

**TERM END EXAMINATION-2008**

Q.1. Fill in the blanks from the choices given herewith:

(a) The ratio between cost of goods sold and average inventory is known as--------------(Current Assets Turnover/Stock Turnover Ratio).

(b) When absolute rupee amounts in financial statements are converted into percentage the financial statement is known as -------------(common Size Statement/Statement of Affairs).

(c) An -----------(Inter-Firm comparison/intra-Firm comparison) would demonstrate the firm’s position vis-a vis its competitors.

(d) An --------(Increase/decrease) in Current Assets causes an increase in Working Capital.

(e) Redemption of debentures is a -------(source/use of Fund).

(f) The number of years cash benefits take to recover the original cost of investment is the -------(Average Rate of Return/Payback Period) of investemtn appraisal.

(g) The discount rate (r) which equates the aggregate present value of the net cash. Inflows with the aggregate present value of cash outflows of a project is known as------ (Accounting Rate of Teturn/Internal Rate of Return).

(h) The phrase under capitalization signifies-------(inadequacy of capital/effective utilization of funds) in an enterprise.

(i) The mix of long-term sources of fund and owners’ equity is known as---------(Capital structure/Capital budget) of a firm.

(j) The term gross working capital refers to the aggregate of-------------(Fixed Assets/Current Assets).

Q.2. Give clear definitions of any five of the following terms:

(a) Net working capital (b) Acid test ratio

(c) Fund from operation (d) Retained earning

(e) Return of Investment (f) Redemption of preference share

(g) Net Present value

Q.3. Explain the two principal objectives of Financial Management and comment of which of them is a more logical crioterion than the other and why?

OR

What do you mean by Capital Budgeting in Financial Management?

Write short notes on any two capital budgeting appraisal methods.

Q.4. What according to you are the factors which determine the working capital needs of a large

Hotel ?

OR

Distiguish between fund flow statement and cash flow statement.

Q.5 State the importance of finanancial statement analysis. Explain any one technique of financial statement ananlysis.

Q.6. Explain any two ratios which are important for management of hotel finance and state any two limitations of ratio analysis.

OR

Write short notes on any two of the following::

(a) Business Finance (b) Financial Planning

(c) Capital Structure (d) Common Size Statement

**TERM END EXAMINATION--2009**

Q.1 What is meant by the term Ratio Analysis in Financial Management?

Classify the different types of Ratios with examples.

Q.2 What is meant by Working Capital ? Discuss the factors which determine working capital needs of a firm.

OR

Discuss the objectives of Financial Management

Q.3. Write short notes on (any two)

(a) Cash Budget

(b) Funds from operation

(c) Common size income statement

Q.4. Define any five of the following terms in not more than five lines each:

(a) Working capital (b) Return on capital employed

(c) Net profit rario (d) Return on shareholders funds

(e) Stock trunover (f) Trend analysis

OR

Explain the following in not more than ten lines each (any two):

(a) Cash flow statement (b) Cost of capital (c) Financial planning

Q.5 Fill in the blanks:

(a) Capital budgeting is also known as------------

(b) There is a time gap between cash inflows and---------

(c) Budgetary control is a system of controlling--------

(d) The cost of capital is the minimum rate of return expected by its-------

(e) Capital gearing refers to the relationship between equity capital and ---------

Q.6. State and explain the differneces between Cash flow statement and Funds flow statement.

**TERM END EXAMINATION 2010**

Q.1 Write short notes on:

1. Pay back period method

2. Net present value method

3. Profitability index method

4. Internal rate of return method.

Q.2. What do you mean by financial planning. Explain the cause of over capitalization.

Q.3. What do you understand by capital structrure ? Mention the factors affecting capital structure.

Q.4. Write the difference between funds flow and cash flow analysis.

Q.5. What do you understand by financial analysis ? Write limitations of financial analysis.

Q.6. Write short notes on any two of the following :

(a) Du pont chart

(b) Under capitalization

(c) Debt-Equity Ratio

(d) Over trading.