



SYLLABUS

Class: - B.B.A. II Semester

Subject: - Financial Management

UNIT – I	Introduction: Concepts, Nature, Scope, Function and Objectives of Financial Management. Basic Financial Decisions: Investment, Financing and Dividend Decisions.
UNIT – II	Analysis and Interpretation of Corporate Final Accounts: Understanding the Parameters of health of Business: Liquidity, Profitability, Solvency and Efficiency through learning computation, analysis and interpretation of various tools of financial analysis Preparation of Cash Flow Statement as per Accounting Standard and its Analysis
UNIT – III	Leverage Analysis: Developing the Concept of Leverage in Finance. Computation and inferences of Degree of Operating Leverage, Financial Leverage and Combined Leverage.
UNIT – IV	Investment Decisions: Analysis of Risk and Uncertainty. Concept and Computation of Time Value of Money, DCF and Non DCF methods of Investment Appraisal. Project selection on the basis of Investment Decisions. Valuating Investment Proposals for Decision Making. Capital Rationing
UNIT – V	Management of Working Capital: Concepts, components, Determinants and need of Working Capital. Computation of Working Capital for a Company.



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MEANING OF FINANCIAL MANAGEMENT

Financial Management may be defined as Planning, Organizing, Directing and Controlling of financial activities in a business enterprise. More specifically it is concerned with optimal procurement and effective utilization of funds in a manner that the risk, cost and control considerations are properly balanced in a given situation.

Financial management is concerned with efficient acquisition and allocation of funds. In operational terms, it is concerned with management of flow of funds and involves decisions relating to procurement of funds, investment of funds in long term and short term assets and distribution of earnings to owners. In other words, focus of financial management is to address three major financial decision areas namely, investment; financing; and dividend decisions.

Definition : "The activity which is concerned with acquisition and utilization of all money/ Funds to be used in a corporate (Business) Enterprise." - *Wheeler*

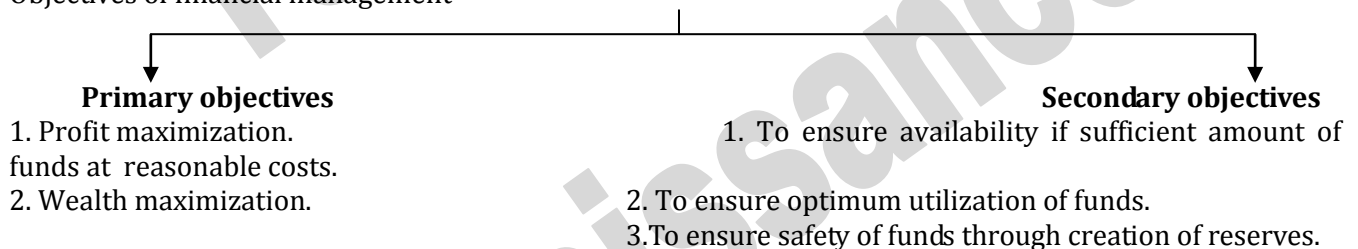
More specifically, Financial Management is concerned with making the following **four decisions**:

1. *Investment decision i.e., where and how much to invest in long-term assets and working capital?*
2. *Financing decision i.e., from where to raise funds?*
3. *Dividend decision i.e., how much earnings to be retained and how much to be distributed?*
4. *Liquidity decision i.e, how much cash in hand is to be maintained with the firm.*

OBJECTIVE OF FINANCIAL MANAGEMENT (***)

The objective of financial management is to maximize the current price of equity shares of the company. However, the current price of equity shares should not be maximized by manipulating the share prices. Rather it should be maximized by making efficient decisions which are desirable for the growth of a company and are valued positively by the investors at large. A decision is considered efficient if it increases the price of share but is considered as inefficient if it results in decline in the share price. In other words, the objective of financial management is to maximize the wealth of the owners of the company, that is the shareholders. Here wealth maximization means the maximization of the market price of the equity shares of the company in the long run by making efficient decisions and not by manipulating the share prices. The financial manager must identify those avenues of investment; modes of financing, ways of handling various components of working capital which ultimately will lead to an increase in the price of equity share. If shareholders are gaining, it implies that all other claimants are also gaining because the equity share holders get paid only after the claims of all other claimants (such as creditors, employees, lenders) have been duly paid.

Objectives of financial management



Nature and Scope of Financial Management : Nature :

1. Management of flow of money.
2. Concept with application of skills in manipulation

Use of Control of Money

Determining financial needs and Raising of funds

Utilization of funds



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1. **Details** : Management of flow money : It refer to Inflow and outflow of money. Inflow of money means Entering of money in business from external source and outflow of money refers to consumption of money. Which gives us the Best output of financial Manager need to concentrate over the inflows as well as outflow of money so that there cannot be shortage and excursiveness of financial resources.

2 **Concerns with application of skills in manipulation, we and control of money** : In an effective financial Management, there is always a process of applying. Manager skills in Manipulate, utilization and control of money. In Financial Management, Controlling of firms financial resources play a vital role that is why a financial manager uses his skills in order to control such activities.

3 **Determining the Financial needs and Raising of Funds** : In financial management, a financial manager, firstly determining the financial needs of an enterprise and then finding out the best suitable sources for raising them. The sources should be commensurate with needs of business. If the funds needed for longer period then long term sources of like share capital, debentures, etc can be raise for short term, period, the short term sources like. Trade Bill, Commercial paper can be.

4. **Proper utilization of funds**: Though raising funds is important but their effective utilization is also more important. The funds should be used in such a that maximum benefit is derived from them. The retires from their use should be more than their cost. It should be ensured that funds do not remain idle at my point of time. The funds committed to various operations should be effectively utilized. Those projects would be preferred which are beneficial to the business.

Scope of financial Management :

1. Estimating Financial Requirement
2. Deciding Capital Structure
3. Selecting a source of finance
4. Selecting a Pattern of investment.
5. Proper Cash Management
6. Implementing Financial controls
7. Proper uses of surpluses.

1. **Estimating Financial Requirements** : The first task of a financial manager is to estimate short-term and long-term financial requirements of his business. For this purpose, he will prepare a financial plan for present as well as for future. The amount required for purchasing fixed assets as well as needs of funds for working capital will have to be ascertained.

2. **Deciding Capital Structure**. The capital structure refers to the kind and proportion of different securities for raising funds. After deciding about the quantum of funds required it should be decided which type of securities should be raised. Long-term funds should be employed to finance working capital also, if not wholly then partially. A decision about various sources for funds should be linked to the cost of raising funds. If cost of raising funds is very high then such sources may not be useful for long.

3. **Selecting a Source of Finance** : After preparing a capital structure, an appropriate source of finance is selected. Various from which finance may be raised, include : share capital, debentures, financial institutions, commercial banks, public deposits, etc. If finances are needed for short periods then banks, public deposits and financial institutions may be appropriate, on the other hand, if long-term finances are required then share capital ad debentures may be useful.

4. **Selecting a Pattern of Investment** When funds have been procured then a decision about investment pattern is to be taken. The selection of an investment pattern is related to the use of funds. A decision will have to be taken as to which assets are to be purchased? The funds will have to be spent on fixed assets and then an appropriate portion will be retained for working capital.



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5. Proper Cash Management : Cash management is also an important task of finance manager. He has to access various cash needs at different times and then make arrangements for arranging cash. Cash may be required to (a) purchase raw materials, (b) make payments to creditors, (c) meet wage bills, (d) meet day to day expenses. The usual sources of cash may be a: (a) cash sales, (b) collection of debts, (c) short term arrangements with bank etc. The cash management should be such that neither there is a shortage of it and nor it is idle. Any shortage of cash will damage the creditworthiness of the enterprise.

6. Implementing Financial Controls: An efficient system of financial Management necessitates the use of various control devices. Financial control devices generally used are : (a) Return on investment, (b) Budgetary Control, (c), Break Even Analysis, (d) Cost Control, (e) Ratio Analysis (f) Cost of Internal Audit return on investment is the best control device to evaluate the performance of various financial policies the higher this percentage, better may be the financial performance.

7. Proper Use of Surpluses. The utilization of profits or surpluses is also an important factor in financial management. A effective use of surplus is essential for expansion and diversification plans and also in protecting the interests of shareholders.

3. Finance Function : Finance function is the most important of all business function. It remains a focus of all the activities it is possible to substitute or eliminate this function because the business will close down in the absence of finance.

Approaches to finance functions -

1. Traditional approaches - According to this approach the finance function was conformed only procurement of funds needed by business on most suitable firms. The utilization of funds was considered beyond the purview of finance function Here, it was felt that decision regarding application of funds are taken same where.

Limitations :

- If completely ignore the decision making to the proper utilization of funds.
- If ignores the important issue of working capital finance and management.
- If ignore issue of allocation of funds.
- If ignore day to day financial problem of organization.

2.Modern Approach : It used in broader firms. It includes both raising and utilisation of funds. The finance function does not stop only by finding out sources of raising enough funds, their proper utilization . According to this approach, it cover financial planning, raising of funds. Allocation of funds and financial control etc.

Aims of Finance Function

1. Acquiring sufficient funds.
2. Proper utilization of funds.
3. Increasing profitability
4. Maximizes firms value.

1. Acquiring Sufficient Funds : The main aim of finance function is to assess the financial needs of an enterprise and then finding out suitable sources for raising them. If funds are needed for longer periods then long-term sources like share capital, debentures, term loans may be explored.

2. Proper Utilization of Funds : Though raising of funds is important but their effective utilization is more important. The funds should be used in such a way that maximum benefit is derived from them. The



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returns from their use should be more than their cost. It should be ensured that funds do not remain idle at any point of time.

3. Increasing Profitability : The planning and control of finance function aims at increasing profitability of the concern. It is true that money generates money. To increase profitability, sufficient funds will have to nor wastes more funds than required.

4. Maximizing Firm's Value : Finance function also aims at maximizing the value of the firm. It is generally said that a concern's value is linked with its profitability. Besides profit, the type of sources used for raising funds, the cost of funds, the condition of money market, the demand for products are some other considerations which also influence a firm's value.

5. Sources of Financial information :

1. Banks
2. Financial institution
3. Government agencies
4. Investors
5. Brokers
6. Media
7. Supplier.

5. Functional Areas Financial Management:

1. Determining financial needs .
2. Selecting the sources of funds.
3. Financial analysis and interpretation
4. Cost volume and profit analysis.
5. Capital Budgeting.
6. Working Capital management
7. Profit Planning and Control.
8. Dividend Policy.

1. Determining financial needs: A finance manager is supposed to meet financial needs of the enterprise. For this purpose, he should determine financial needs of the concern. Funds are needed to meet promotional expenses, fixed and working capital needs.

2. Selecting the Source of Funds: A number of sources may be available for raising funds a concern may resort to issue of share capital and debentures. Financial institutions may be requested to provide long term funds. A finance manager has to be very careful and cautious in approaching different sources. The terms and conditions of banks may not be favourable to the concern.

3. Financial Analysis and Interpretation: The analysis and interpretation of financial statements is an important task of a finance manager. He is expected to know about the profitability, liquidity position, short term and long-term financial position of the concern. For this purpose, a number of ratios have to be calculated. The interpretation of various ratios is also essential to reach certain conclusions. Financial analysis and interpretation has become an important area of financial management.

4. Cost -Volume -Profit Analysis : Cost-volume-profit analysis is an important tool of profit planning. The costs may be subdivided as : fixed costs, variable costs and semi-variable costs. Fixed costs remain constant irrespective of changes in production. An increase or decrease in volume of production will not influence fixed costs. Variable costs, on the other hand, vary in direct proportion to change in production. Semi-variable remain constant for a period and then become variable for a short period.

5. Capital Budgeting : Capital budgeting is the process of making investment decisions in capital expenditures. It is an expenditure the benefits of which are expected to be received over a period of time exceeding one year. Capital budgeting decisions are vital to any organization. An unsound investment decision may prove to be fatal for the very existence of the concern.



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6. Working Capital Management : Working capital is the life blood and nerve center of business. Just as circulation of blood is essential in the human body for maintaining life, Working capital is essential to maintain the smooth running of business. No business can run successfully without an adequate amount of working capital. Working capital refers to that part of the firm's capital which is required for financing short term or current assets such as cash, receivables and inventories. It is essential to maintain a proper level of these assets.

7. Profit Planning and Control : Profit planning and control is an important responsibilities of the financial manager. Profit maximization is, generally, considered to be an important objective of a business. Profit is also used as a tool for evaluating the performance of management. Profit is determined by the volume of revenue and expenditure.

8. Dividend Policy : Dividend is the reward of the shareholders for investments made by them in the share of the company. Their investors are interested in earning the maximum return on their investment whereas management wants to retain profits for further financing. The company should distribute a reasonable amount as dividends to its members and retain the rest for its growth and survival.

FINANCIAL PLANNING

MEANING OF FINANCIAL PLANNING

Financing Planning means deciding in advance the requirements as well as sources of funds. Financial Planning is process of estimating the fund requirements of a business and determining the sources of funds. Thus, there are two aspects of financial planning:

1. How much funds are required to finance

(a) current assets (b) Fixed assets and (c) Future expansion project.

2. From where to raise these funds?

(a) Whether funds to be raised through Owners' Funds (equity) or Borrowed Funds (Debt);

(b) How much funds to be raised through Owners' Funds (equity) – Equity share, Preference Shares; reserves & Surplus.

(c) How much funds to be raised through Borrowed Funds (Debt) – Debentures, Long-term loans.

The aforesaid decisions should be taken keeping in mind three factors viz. Cost, risk and control. There should be a proper mix of various sources in such a manner that the funds are procured at optimum cost with the least risk and the least dilution of control of the present owners. .

Financial planning takes into consideration the growth, performance, investments and requirements of funds for the business for a given period of time. The time horizon of financial planning is generally 3-5 years.

Short-term financial plans called budgets are also drawn up\ to show the revenues and expenses relating to specific operation for a specific period of 1 year or less.

IMPORTANCE OF FINANCIAL PLANNING

The importance of financial planning in financial management arises from the following benefit which flow from it:

1. It provides policies and procedures which make possible a closer cooperation between various functions of the business enterprise.
2. It aids the company in preparing for the future.
3. It provides a detailed plan of action for reducing uncertainty and for the proper direction of individual and group efforts.
4. It avoids confusion and waste such as loss of time, goodwill and financial resources.
5. It helps management to avoid waste resulting from complexity of operations.
6. It tends to relieve top management from detailed and time consuming process as the financial units are known to everyone. It communicates expectations to all concerned so that they are properly understood



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and implemented.

7. The success or failure of production and distribution functions of the business depends on the financial decision.

MEANING OF WORKING CAPITAL

Working Capital refers to funds required to be invested in the business for a short period usually upto one year. It is also known as short-term capital or circulating capital or working capital.

Working capital is sometimes known as circulating capital or revolving capital because funds invested in current assets are continuously recovered through the realization of cash and again reinvested in current assets. Thus, the amount keeps on circulating or revolving from cash to current assets and back again to cash.

CONCEPTS / TYPES OF WORKING CAPITAL

I) On the basis of concept :

a. **Gross working capital:** It refers to all the current assets taken together.

b. **Net working capital :** It is the surplus of current assets over and above current liabilities.

(i) A **positive net working capital** occurs when current assets exceed current liabilities;

(ii) A **negative net working capital** occurs when current liabilities exceed current assets. A negative working capital implies -ve liquidity and the company is not likely to be able to payoff even its current liabilities & hence may considerably damage its reputation. A weak liquidity position is perceived as a threat to the solvency of the company

II) On the basis of time :

a. **Permanent capital:**

i. **Regular Working capital:** It is the working capital required to ensure circulation of inventories.

ii. **Reserve working capital:** It is the excess amount over the requirement of regular working capital which may be provided for contingencies.

b. **Temporary working capital :**

i. **Seasonal working capital:** It is required to meet seasonal demands.

ii. **Special working capital:** It is required to meet special occasion such as launching of extensive marketing campaign.

Factors affecting working capital requirements CONFIRM QUESTION

1. **Nature of business:** There are some business which require higher initial capital and lesser working capital whereas some business require lower initial capital and larger amounts of working capital.

2. **Credit policy:** Liberal credit policy will require higher and strict dividend policy will require low working capital.

3. **Production cycle:** If length of production cycle is big it will require larger working capital and vice versa.

4. **Seasonal operations:** Larger amounts of working capital is required for seasonal products because they are produced once and sold throughout the year.

5. **Inventory policy :** If firm wishes to maintain higher stock levels then higher working capital is required and if lesser amount of inventory levels are maintained, it will require lesser working capital.

6. **Business cycle fluctuations:** During Boom, higher working capital is required and lesser working capital is required during depression.

7. **Working capital cycle :** If the time gap between raw materials purchased and its conversion into cash is big large working capital is required by the firm and vice versa.

8.

MANAGEMENT OF FIXED CAPITAL/ Capital budgeting

MEANING - Fixed capital refers to investment in long term assets. Management of fixed capital involves allocation of firm's capital to different long term assets. These decisions are called investment decisions or



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capital budgeting decisions. These affect decisions affect the growth, profitability and risk of the business in the long run. These long term assets yield benefits over a long period, usually more than one year.

Purpose - The purpose of capital budgeting decision is to acquire long-term assets (such as land, building, plant, machinery)

- a. for setting up new business;
- b. for expansion (e.g. increasing existing plant capacity from 1000 tones to 2000 tonnes);
- c. for diversification (e.g. a car manufacturer switches over to insurance business)
- d. for modernization (e.g. replacing an old plant by new one)

Why are Capital Budgeting Decisions important?

The management of fixed capital or investment or capital budgeting decisions are important for the following reasons.

1. Long-term growth and effects - These decisions affect the rate and direction of long-term growth of the enterprise because a wrong decision can adversely affect the survival of the firm. *For example*, an unprofitable expansion of assets will result in heavy operating costs to the enterprise. These decisions have long-term implications for the enterprise because the effects of investment decision extend into the future.

2. Large amount of funds involved - These decision involve large investment in long-term assets. Therefore these decisions are planned after careful evaluation of various projects.

3. Risk Involved - These decisions involve risk and uncertainty associated with the future cash flow of the project. Since the actual cash flows may not match the expected cash flows, the rate of earning may fluctuate and the firm may become more risky.

1. Irreversible Decision - These decisions once taken are not easily reversible without incurring heavy losses. The firm will incur heavy losses if long-term assets are scrapped on reversing the investment decisions.

FACTORS AFFECTING CAPITAL BUDGETING DECISIONS

The following factors affect the capital budgeting decisions

1. Cash Flows of the Project - The entire cash flows of the project expected over the life of the project should be considered before taking a capital budgeting decision. These cash flows are in the form of a series of cash receipts and payments over the life of the project.

2. The Rate of Return - The expected rate of return and risk of each project should be considered before taking a capital budgeting decision. Suppose, there are two projects A and B (with the same risk involved) with a rate of return of 12 per cent and 15 per cent respectively, then under normal circumstances, project B will be selected.

3. The Investment Criteria Involved - There are different techniques to evaluate investment proposals which are known as capital budgeting techniques (such as Net Present Value, Internal Rate of Return). These techniques should be applied to each proposal before selecting a particular project.

Q. What are the major sources of long-term finance?

Ans. Major sources of long term finance are as follows:

1. Equity Shares: It refers those shares which represent ownership position in a company. Shareholders are regarded as the owners of the company, and they have right to participate in its management. **The main features of these are discussed as under:**

- i) **Voting rights:** Equity shareholders have right to vote in the mgt. of the company to elect director etc.
- ii) **Non-redeemable:** It is a permanent source where funds are never refunded back until and unless liquidation of the company.
- iii) **Basis of control:** It provides basis on which owners acquire the right of control over management.
- iv) **Share of profit:** Shareholders receive share of profit in the form of dividend.



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- v) *Limited liability*: The shareholders have limited liability to the extent of shares they have purchased indifferent from partnership and sole proprietorship where owner have unlimited liability.
- vi) *Claim over assets*: The shareholders have claim over the residual assets of the company in case of liquidation.

Merit and limitations of equity share capital from point of view of company:

Merits:	Limitations
i) Permanent capital. ii) No fixed obligation. iii) No security. iv) No risk of financial insolvency. v) Enhances the capacity to raise funds. vi) Basis of control. vii) Beneficiary of trading on equity.	i) Highest cost. ii) Risk of loss of control. iii) Not attracts many investors.

Merits of equity share capital from the point of view of shareholders:

Merits	Limitations
i) Voting rights. ii) High dividend. Bonus Shares. Capital appreciation: They may get appreciated in the value of their shares. iii) High liquidity.	i) Uncertainty of earnings: ii) High risks: iii) Inability to participate in the management iv) No security: v) No control over increase in rate of dividend:

2. Preference shares: A preference share is one which carries the following two rights:
 Preference of right to receive dividend.
 Preference in repayment of capital.

MERITS and DEMERITS of preference share capital:

MERITS	DEMERITS :
1. Dividend Not Charge 2. No Risk of Loss of Control 3. No Security - 4. No Risk of Financing Insolvency - 5. Low Cost. 6. Advantage of Trading on Equity -	1. Cost Higher than that of Debt- 2. Not Permanent Capital- 3. Not Attracts many investors -

Merits and Limitations of Preference Share Capital from the Point of View of Shareholders

Merits	Limitations
1. Preferential right as to the payment of dividend 2. Preferential right as to the repayment of capital 3. No Reduction in Dividend 4. Accumulation of Dividend 5. Redeemable.	1. No Voting Rights 2. No Capital Appreciation 3. No Increase in Dividend



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Debentures:

A debenture is an instrument issued by the company acknowledging its debts to the holder under its seal. Debentures carry interest at certain fixed percent. As it is a loan taken by the company, it is repaid after certain specified period or at the option of the company as per the terms of their issue. There are no legal restrictions on the price for which debentures are issued. Debentures may be issued at par, at discount or at premium like shares. Debenture holders are the creditors of the company. They are paid interest on their debentures regularly at fixed rate.

<i>Advantages of debentures:</i>	<i>Disadvantages of raising funds through debentures</i>
1. Availability of necessary funds. 2. No interference in the management. 3. Fixed rate of interest. 4. Facility to return loan. 5. Regular source of income. 6. Safe and secured investment.	1. Disadvantages to financially unsound company. 2. Pledging assets. 3. No participation in the management.

Difference between SHAREHOLDERS and DEBENTUREHOLDERS

Points of difference	Shareholders	Debenture holders
1. Meaning	The subscribers to the shares are Shareholders. Shares are the parts of share capital.	Debenture, holders are the subscribers to debentures. Debentures are parts of loan.
2. Status	They are the owners of the company	They are the creditors of the company
3. Return	Shareholders are paid dividend on their holdings	Debenture, holders are paid interest on debentures held by them
4. Regularity of return	Dividends are paid, when there is sufficient profits. The rate of dividend is not fixed. Dividends are not the regular source of income	Interest on debentures is paid at fixed rate regularly.
5. Security	Shares are not secured	Debentures are ordinarily secured.
6. Right to attend	Shareholders are invited to attend the annual general meeting of the company.	Debenture, holders are not invited, unless any decision affecting their interest is taken.
7. Repayment	Share Capital is not returned except in case of redeemable preference shares.	Debentures being loan is repaid by the company.
8. Priority of refund	In case of dissolution of the company/ shareholders funds are refunded after every claim is settled.	Debenture holders have a priority of the refund of their loan prior to shareholders.
9. Restriction on issue	There are certain restrictions on issue of shares at discount.	There are no restrictions as to issue of debentures at discount.
10. Control	Shareholders control the affairs of the company. It is managed by the Board of Directors.	They are not involved in the management and control of the company

Note: These notes are to be elaborated as per the instructions in the classroom



Q2. What is difference between Management Accounting and Financial Accounting. (02,03,05,06)

Points	Management Accounting	Financial Accounting
1. Object	The object of Management Accounting is to provide reliable and relevant accounting information to management	The object of Financial Accounting is ascertain Profit and Loss (Income Statement)& Balance Sheet (Position Statement at the end of the accounting year
2. Nature	Management Accounting deals with data for forecasting. It takes decisions regarding future. It deals with estimated figure.	Financial Accounting deals with historical data. It records the data related to transaction already took place. It deals with actual figures.
3. Users	Management Accounting focuses on internal users like management, employers, etc.	Financial Accounting focuses on external users like creditors, shareholders bank and investors and Govt.
4. Compulsory	It is not compulsory for an undertaking to prepare Management Accounting	It is compulsory for an undertaking to prepare Financial Accounting as per companies act 1956 it is binding for a company to submit a copy of Final Accounts with the registrar.
5. Principles	Management Accounting is not governed by any kind of principles or conventions.	Financial Accounting is governed by some principles and conventions known as GAAP.
6. Period	Management Accounting is not prepared for a particular period rather it supplies accounting information to management from time to time i.e. as and when needed.	Financial Accounting is prepared for a particular period Generally for 1 year or 6months ending on 31 st March or 31 st Dec of an year .
7. Precision	Management Accounting does not emphasis on actual figures. The approximate figures are considered more useful than the exact figures.	Financial Accounting emphasis put only on actual figures. The transactions are recorded only when they have took place so exact figures are used.
8. Publication	Management Accounting statements are prepared for the benefit of the management only and these are not published.	Financial Accounting like income statements and position statements are published for the benefit of different user.
9. Coverage	Management Accounting seats every department as a separate entity for decision making. Each activity is considered separately	Financial Accounting takes into account each and every transactions which has some money worth
10. Audit	Management Accounting account cannot be audited. It is based on projected figures so it is not possible to get Management Accounting audited	Financial Accounting can be got audited. Under companies Act 1956 auditing of Financial Accounting is compulsory. It is based on Historical data so its auditing is possible.
11. Quickness	Reporting of Management Accounting is very Quick. Management Accounting produce reports at regular intervals.	Reporting of Financial Accounting is very low and time consuming. As it is prepared at the end of every year.



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Q5 What is ratio analysis? Explain its importance and limitations. (May '02)

Ratio is a simple arithmetical expression of the relationship of one number to another.

In the words of Wixon and Bedford, a ratio is an expression of the quantitative relationship between two numbers. Ratio analysis is the relationship between two accounting data.

Ratio Analysis are one of the methods of analysing financial statements. The financial statements are in detail and do not present the required information at a glance. Accountants have to work very hard in digging out the required information. Accounting ratios are therefore, an attempt to present the information of the financial statements in simplified, systematised and summarised form.

Ratio analysis measures the profitability, efficiency and financial soundness of the business. The relationship between two facts *i.e.*, gross profit and sales or current assets and current liabilities is studied and the result is presented in the form of simple ratios.

According to Myers, ratio analysis is a "study of relationship among the various financial factors in a business."

METHODS OF EXPRESSING ACCOUNTING RATIOS/RATIO ANALYSIS

The analysis of the financial statements can be presented by one of the following methods:

1 Percentage Method. The relationship between two figures is presented in percentage. For example, if sales is Rs. 1,00,000 and gross profit is Rs. 25,000, the relationship can be presented as gross profit to be 25% of sales, *i.e.*,

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Net Sales}} * 100 = \frac{25,000}{1,00,000} * 100 = 25\%$$

In this way, it is a common practice to present gross profit, net profit, expenses and operating ratio by percentage method.

2. Rate or 'So many times' Method. According to this method, one figure is expressed in terms of the other relative figure. In the previous example, where sale is Rs. 1,00,000 and gross profit is Rs. 25,000 the relationship between the two can be said as gross profit to be .25 times or 1/4th of sales *i.e.* 25,000/1,00,000 or sales to be 4 times of gross profit. It is customary to calculate stock turn over, current and liquid ratios according to rate method.

3. Ratio Method. The relationship between two figures is presented in ratio, such as in the above example, the ratio of gross profit to sales can be said to be 25,000 : 1,00,000 or 1 : 4. In other words, the ratio between sales and gross profit may also be known as 1,00,000 : 25,000 or 4 : 1.

These are 3 different methods of ratio analysis of financial statements but they lead to the same conclusion..

Ratio analysis is therefore a tool to present the figures of financial statement in simple, concise and intelligible form. Ratio analysis, in this way is the process of establishing meaningful relationship between two figures or set of figures of financial statement.

OBJECTIVES OF ACCOUNTING RATIO

Accounting ratio are true test of the profitability efficiency and financial soundness of the company.

(i) Measurement of the Profitability. We can measure the profitability of the business by calculating gross profit, net profit, expenses and other ratios. Profitability is the profit earning capacity of the business so profitability ratios indicate the actual performance of the business. If these ratios fall, effective corrective measures will be applied to improve the working of the business.

(ii) Judging the operational efficiency of management. The operational efficiency of the business can be ascertained by calculating operating ratio. As the operating ratio shows the operational cost of the business so it will be in the interest of business if it is lower. We use operating net-profit for calculating operating net profit ratio, wherein non-operating expenses and incomes are not taken into consideration.



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(iii) Assessing the efficiency of the business. We can ascertain whether the firm is solvent or not by calculating solvency ratios. Solvency ratios show relationship between liabilities and assets. If total assets are lesser than the outside liabilities it shows unsound position of the business. In such case the business will try its best to improve its solvency *i.e.*, ability to repay loans.

(iv) Measuring short and long term financial position of the company. We can know the short term and long term financial position of the business by calculating various ratios. Current and liquid ratios indicate short term financial position, whereas debt equity ratios, fixed assets ratios and proprietary ratios show long term financial position. In case of unhealthy short term or long term financial position, efforts are made to improve them

(v) Facilitating comparative analysis of the performance. Every promising company has to compare its present performance with the previous performance and discover the plus and minus points. These points can be located by the calculation of different ratios. Causes responsible for poor performance have to be removed. Comparison with the performance of other competitive firms can also be made.

Comparison tells, where the firm stands and what are its prospects. It enables both intra-firm and inter-firm comparison.

(vi) Indicator of true efficiency. Financial statements *i.e.*, Trading P/L Account and Balance sheet may indicate the amount of profit or the balances of different accounts but the profitability can be known by analysis of financial statements *i.e.*, calculation of accounting ratios. Calculation of gross profit, net profit, operating and earning ratios shows the profit earning capacity of business.

(vii) Helpful in budgeting and forecasting. Accounting ratios provide a reliable data, which can be compared, studied and analysed. These ratios provide sound footing for future forecasting. They indicate the future prospects. The ratios can also serve as a basis for preparing budgets and also determining future line of action.

(viii) Helpful in simplifying accounting figures. Accounting ratios make the figures simple and intelligible. They simplify, summarise and systematize the long monotonous figures. The ratios can be easily understood by those who do not know accounting. The importance of the ratios lies in the fact that they provide relationship between different figures.

(ix) The ratio analysis is also useful to shareholders who know the profitability of the company, to creditors, who know solvency of the business, to potential investors in assessing earning potential, to workers for computation of the bonus and even to the Government in judging the progress of industry as a whole.

LIMITATIONS OF ACCOUNTING RATIOS/RATIO ANALYSIS

Accounting ratios are insignificant alone. These ratios become meaningful when they are compared with the previous performance of the firm or with the performance of other firms. The ratios, though indicate profitability, efficiency and financial soundness, but they are not the solution of all problems.

Accounting ratios suffer from the following limitations:

1. False results. Ratios are based upon the financial statements. In case, financial statements are incorrect or the data upon which ratios are based is incorrect, ratios calculated will also be false and defective. The accounting system itself suffers from many inherent weaknesses, so the ratios based upon it can not be said to be always reliable.

2. Limited Comparability. The ratio of the one firm can not always be compared with the performance of other firm, if uniform accounting policies are not adopted by them. The difference in the methods of calculation of stock or the methods used to record the depreciation on assets will not provide identical data, so they cannot be compared.

3. Absence of standard universally accepted terminology. Different meanings are given to particular term, such as some firms take profit before interest and after tax, others may take profit before interest and tax. Bank overdraft is taken as current liability but some firms may take it as non-current. The ratios can be comparable only when uniform terminology is adopted by both the firms.

4. Price level changes affect ratios. The comparability of ratios suffers, if the price of the commodities in two different years as not the same. Change in price affects the cost of production, sales and also the value of



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assets. It means that the ratio will be meaningful for comparison, if the prices do not change.

5. Ignoring qualitative factors. Ratio analysis is the quantitative measurement of the performance of the business. It ignores the qualitative aspect of the firm, how so ever important it may be. It shows that ratio is only one-sided approach to measure the efficiency of the business.

6. No single standard ratio. There is not a single standard ratio which can indicate the true performance of the business at all time and in all circumstances. Every firm has to work in different situations and circumstances, so a particular ratio can not be supposed to be standard for every one. Strikes, lock-outs, floods, wars, etc. materially affect the performance, so it can not be matched with the circumstances in normal days.

7. Misleading results in the absence of absolute data. In the absence of actual data, the size of the business can not be known. If gross profit ratio of two firms is 25%. It may be just possible that the gross profit of one is 2,500 and sales Rs. 10,000, whereas the gross profit and sales of the other firm is Rs. 5,00,000 and sales 20,00,000. Profitability of the two firms is the same but the magnitude of their business is quite different.

8. Window Dressing. Many companies, in order to depict rosy picture of their business indulge in manipulation. They conceal the material facts and exhibit false position. It makes the financial statements and the ratio analysis based upon these statement defective. The process of manipulation includes under statement of current liability, over statement of current assets, recording the transaction in the next financial year, showing the purchases of raw material as purchases of assets etc. Window dress restricts the utility of ratio analysis.

Impressed by personal bias and ability of the analyst. **Accounting as we know is not an exact science. There is no complete universally accepted terminology. There are many interpretations to particular accounting information. This is why, accounting results are affected by the ability of the analyst. If the analyst is biased, he will prove his point of view by manipulation and ratio analysis will be defective.**



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Working Capital Management

Q.1 From the following information prepare a statement showing the working capital requirements:

Budgeted sales(In Unit) 2,60,000 p.a

Analysis of one rupee of sales:

• Raw Material	0.30
• Direct Labour	0.40
• Overheads	0.20
• Total cost	0.90
• Profit	0.10
• Sales	1.00

It is estimated that:

- Raw materials are carried in stock for 3 weeks and finished goods for 2 weeks.
- Factory processing will take 3 weeks. (Raw material @ 100% & 50% for labour & overheads)
- Suppliers will give 5 weeks credit.
- Customers will require 8 weeks credit.
- Wages & overhead to be accrued evenly throughout the year.

[Ans: Rs. 51,000]

Q.2 The Management of Vishal Ltd has called for a statement showing the working capital needed to finance a level of activity of 3,00,000 units of output for the year. The cost structure for the company's product, for the above mentioned activity level is detailed below:

	Cost per unit
• Raw Materials	20
• Direct Labour	5
• Overheads	<u>15</u>
• Total	40
• Profit	<u>10</u>
• Selling price	<u>50</u>

1. Past experience indicates that raw materials are held in stock, on an average for 2 months. Work in process (100% complete in regard to materials and 50% for labour and overheads will approx be to half a month's production.
2. Finished goods remain in warehouse, on an average for a month.
3. Suppliers of materials extend a months credit.
4. Two months credit is allowed to debtors, calculation of debtors may be made at selling price.
5. A minimum cash balance of Rs. 25,000 is expected to be maintained.
6. The production pattern is assumed to be even during the year. Prepare the statement of working capital requirements.

[Ans: Rs. 44,00,000]

Q.3 The Board of directors of Nanak Engineering Company private Ltd requests you to prepare a statement showing the Working Capital Requirements for a level of activity of 1,56,000 units of production. The following information is available for your calculations:

(A)	Per unit (Rs.)
1. Raw materials	90
2. Direct Labour	40
3. Overheads	75
4. Profit	60
5.Selling price per unit	265



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(B) Raw materials are in stock, on average one month.

1. Materials are in process, on average 2 weeks.
2. Finished goods are in stock, on average one month.
3. Credit allowed by suppliers, one month.
4. Time lag in payment of wages 1.5 weeks.
5. Lag in payment of overheads is one month.
6. Debtors are allowed 6 weeks credit

20 % of the output is sold against cash. Cash in hand and at bank is expected to be Rs. 60,000. It is to be assumed that production is carried on evenly throughout the year, wages and overheads accrue similarly and a time period of 4 weeks is equivalent to a month.

Q.4 The Board of Directors of Rich and poor Co. Ltd. requests you to prepare statements showing the working capital requirement for a level of activity at 1,56,000 units of production.

	Per unities of (Rs.)
(A) Raw Materials	180
Direct Labour	80
Overheads	<u>150</u>
Total	410
Profit	<u>120</u>
Selling Price per unit	<u>530</u>

(B)

- (i) Raw materials are in stock, on average one month.
- (ii) Materials are in process, on average 2 weeks.
- (iii) Finished good are in stock, on average one month.
- (iv) Credit allowed by suppliers, one month.
- (v) Time lag in payment from debtors, 2 months.
- (vi) Average time lag in payment of wages, 1.5 weeks.
- (vii) Average time lag in payment of overheads is one month.

20% Of the output is sold against cash. Cash in hand and at bank is expected to be Rs. 1,20,000. It is to be assumed that production is carried on evenly throughout the year, wages, and overheads accrue evenly and a time period of 4 weeks is equivalent to month.

Note: WIP assumed 50% in respect of labour and overheads.

[Ans. 1,25,22,000]

Q.5 The following data is available from the cost sheet of a Company.

	(Cost per unit)
Raw Material	50
Direct Labour	20
Overhead (including depreciation of Rs. 10)	40
Total Cost	110
Profit	20
Selling Price	3130

Additional information.

Average raw material in stock is for one month. Average material in progress is for half month. Credit allowed by suppliers is one month; credit allowed to debtors is one month. Average time lag in payment of wages: 10 days; average time lag in payment of overheads 30 days. 25% of the sales are on cash basis. Cash balance expected to be Rs. 1,00,000. Finished goods life in the warehouse for one month. You are required to prepare a statement showing the working capital needed to finance a level of the activity of 50,000 units of output. Production is carried out evenly throughout the year ad wages



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and overheads accrue similarly. State you assumptions is any, clearly.

Q.6 While preparing a project report on behalf of a client you have collected the following facts. Estimate the net working capital required for that project. Add 10% to your computed figure to allow contingencies..

	Amount per unit Rs.
Estimated cost per unit of production is:	
Raw Materials	80
Director Labour	30
Overhead (exclusive of depreciation)	60
Total Cost	170
Additional Information:	
Selling price	Rs. 200 per unit
Level of activity	1,04,000unit of production per annum.
Raw materials in stock	average 4 weeks
Work in progress (assume 50% completion stage in Respect of conversion costs)	average 2 weeks
Finished goods in stock	average 4 weeks
Credit allowed by suppliers	average 4 weeks
Credit allowed to debtors	average 8 weeks
Lag in payment of wages	average 1.5 weeks
Cash at bank is expected to be	Rs. 25,000
You may assume that production is carried on evenly throughout the year (52 weeks) and wages and overheads accrue similarly.	
Alls sales are on credit basis only. [Ans. 49,66,500]	

Q.7 The management of Royal industries has called for a statement showing the working capital to finance a level of activity of 1,80,000 units of output for the year. The cost structure for the company product for the above mentioned activity level in detailed below:

	Cost per unit (Rs.)
Raw material	20
Direct labour	5
Overheads (including depreciation of Rs.5 per unit)	15
	40
Profit	10
Selling Price	50

Additional Information: (a) Minimum desired cash balance is Rs. 20,000.
 (b) Raw materials are held in stock on an average, for two months.
 (c) Work in progress (assume 50% completion stage) will approximate to half -a- month's production
 (d) Finished goods remain in warehouse, on an average, for a month.
 (e) Suppliers of materials extend a month's credit and debtors are provided two month's credit cash sales are 25% of total sales.
 (f) There is a time - lag in payment of wages of a month and half a month in the case of overheads.
 From the above facts you are required to prepare a statement showing working capital requirements.
 Note: Depreciation is a non - cash item therefore it has been excluded from total cost as well as working capital provided by overheads. Work in progress has been assumed to be 50% complete in respect of labour and overheads expenses.

Q.8 The following information has been submitted by a borrower:

- (a) Expected level of production 1,20,000 units.
- (b) Raw material to remain in stock on average 2 months.
- (c) Processing period for each unit of product 1 months.



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Overheads 10%

Production in 1999 was 2,00,000 units and it is proposed to maintain the same during 2005. The following particulars are available:

- (a) Raw materials are expected to remain in stores for an average period of one month before issue to production.
- (b) Finished goods to stay in the warehouse for two months on the average before being sold out.
- (c) Each unit of production will be in process for one month on the average.
- (d) Credit allowed by the suppliers in one month.
- (e) Credit allowed to debtors is two months.
- (f) Selling price is Rs. 9 per unit.
- (g) Sales and production follow a consistent pattern.

Prepare an estimate of working capital requirement for A Ltd.

Q.12 The annual capacity of ABC Ltd. is to produce 1,20,000 units. The selling price is Rs.10 per unit. The ratios of cost to selling price are as follows:

Raw material	-	20%
Direct Wages	-	40%
Overheads	-	30%

Raw material remain in store on an average one month while processing takes two months with full materials and 50% of other expenses, Finished goods remain in warehouse for one month 25% sales is made against cash and rest at 3 months credit. The supplier provides one month credit and wages are paid 15 days in arrear. The company requires a minimum cash balance of Rs. 50,000. Prepare a statement of working capital requirement of ABC Ltd. assuming 10% for contingencies.

Q.13. Mfg Company sells goods in the home market and earns a gross profit of 20 % on sales. Its annual figures are as follows:

Sales	3,00,000
Materials used	1,08,000
Wages	96,000
Mfg expenses	1,20,000
Administrative and other expenses	30,000
Selling and Distribution expenses	18,000
Depreciation	12,000
Income Tax payable in 4 installments of which one falls in the next financial year	60,000

Additional information is as follows:

- Credit given by suppliers of materials is 2 months.
- Credit allowed to customers is 1 month.
- Wages are paid half a month in arrear.
- Mfg and administrative expenses are paid one month in arrear.
- Selling and distribution expenses are paid quarterly in advance.
- The company wishes to keep one month stock of raw materials and also of finished goods.
- The company believes in keeping cash of Rs. 50,000 including the overdraft limit of Rs. 20,000 not yield utilized by the company.
- You are required to prepare a statement showing the working capital requirements of the company adding 10% margin for contingencies.

[Ans Rs. 53,900: Depreciation and Income Tax have been ignored.]

Q14. 'XYZ' Ltd. sells its products on a gross profit of 20% of sales. The following information is extracted from its annual accounts for the year ending 31st Dec., 1999 :

	Rs
Sales (At 3 months credit)	40,00,000



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Raw Materials	12,00,000
Wages (15 Days in Arrears)	9,60,000
Manufacturing and General Expenses (One month in arrear)	12,00,000
Administration. Expenses (One month in arrear)	4,80,000
Sales Promotion Expenses (Payable Half Yearly in Advance)	2,00,000

The company enjoys one months credit from the suppliers of raw material and maintains: two months stock of raw materials and one and a half month of finished goods. Cash balance is maintained at Rs. 1,00,000 as a precautionary balance. Assuming 10% margin, find out the working capital requirement of XYZ Ltd.



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Capital Budgeting

P PAY BACK PERIOD METHOD

Q.1. A company has to choose one of the following two mutually exclusive projects. Both the project has to be depreciated on straight-line basis. The tax is 50%.

	Cash Inflows	
	Project A (Rs.)	Project B (Rs.)
0	(15,000)	(15,000)
1	4,200	4,200
2	4,800	4,200
3	7,000	4,000
4	8,000	5,000
5	2,000	10,000

You have use Pay-back as the criterion.

Ans. PBP : Project A 2 Years 10 Month, B 3 Years 6.24 Month.
Project A is preferable.

Q.2. X Ltd. has to choose one of the following two mutually exclusive investment proposals. Both the proposals have to be depreciated on straight line method. The tax rate may be assumed to be 50%. The details are given below:

	Proposal I (Rs.)	Proposal II (Rs.)
Cost of outlay	1,50,000	1,50,000
Profit Before Tax :		
Year 1	42,000	42,000
2	48,000	45,000
3	70,000	40,000
4	80,000	50,000
5	20,000	1,00,000

Which proposal should be accepted. Use Pay-back period as criterion for evaluation.

[Ans. P.B.P. Proposal I-2 yrs 8⁴/₁₃ Month Proposal II-2 yrs. 11⁴/₂₅ Month. Proposal I should be accepted.]

Q.3. Incremental Investment in a project would be Rs. 1, 00,000 and its useful life will be 5 years. Incremental cash advantages out of it are estimated as follows:

Years	Advantages
1	Rs. 25,000
2	35,000
3	40,000
4	40,000
5	40,000

The required rate of return is 10%. Using the discounted pay back method, advise whether the project is



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acceptable or not.

[Ans. 3Years 8 Months]

Q.4. A limited company is considering the purchase of a new machine which will carry out some operations performed by labour. X and Y are alternative models. From the following information, you are required to prepare a profitability statement and workout the pay-back period for each method.

(Amount in Rs.)		
	Model X	Model Y
Estimated life	5 years	6 years
Cost of Machine	1,50,000	2,50,000
Cost of Indirect Materials	6,000	8,000
Estimated Saving in Scrap	10,000	15,000
Additional Cost of Maintenance	19,000	27,000
Estimated Savings if Direct Wages :		
Employees not required	150	200
Wages per Employee	600	600

Taxation to be regarded 50% of profit. Ignore depreciation. Which model would you recommend?

[Ans. Model X is recommended]

Q.5. Using the information given below, compute the pay-back method, and (b) discounted pay-back method and comment upon the result:

Particular	Rs.
Initial Outlay	80,000
Estimated Life	5 years
Profit After Tax :	
I year	6,000
II year	14,000
III year	24,000
IV year	16,000
V year	Nil

Depreciation has been calculated under straight line method. The cost of capital may be taken at 20% and PV of Rs. 1 at 20% p.a. is given below :

Year	1	2	3	4	5
PVF	0.83	0.69	0.58	0.48	0.40

[Ans : Pay-back period :

Traditional = 2 Years 8.4 Months

Discount = 4 Years 4.65 Months]

NET PRESENT VALUE METHOD

Q.6. B. Co. is considering investment in either one of the two alternative projects both with life of 5 years and the following information are given :

	Project A (Rs.)	Project B (Rs.)
Capital Investment year 0	(1,00,000)	(80,000)
1	30,000	40,000
2	30,000	35,000
3	30,000	30,000
4	30,000	25,000
5	30,000	10,000

The expected rate of return is 20% p.a.



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The present value of Rs. 1 at 20% from year 1 to 5 is as under :

Year	1	2	3	4	5
Present Value	0.833	0.694	0.579	0.482	0.402

You are require to calculate the comparative profitability of the projects by using Net Present Value Method.

[Ans. Project A Rs. (-) 10,300; B Project Rs. 11,050]

Q.7. A company is considering two mutually exclusive proposal X and Y. Proposal X will require an initial cost of Rs. 1,40,000 with no salvage value and will also require an increase in the level of inventories and receivable of Rs. 60,000 over its life. The Project will generate an additional sales of Rs. 1,30,000 and will require Cash Expenses of Rs. 40,000 in each of its 5 years life. It will be depreciated on straight line method.

Proposal Y will require an initial capital of Rs. 2,00,000 including working capital of Rs. 50,000 will no salvage value and will be depreciated on straight line method. Earnings before depreciation and taxes during its 5 years life are estimated as below :

Year	1	2	3	4	5
CFBT (Rs.)	70,000	76,000	80,000	90,000	92,000

The company pays 50% tax on income

Its require rate of return is 10%

- (a) Which project is to be chosen under the NPV method ?
- (b) Will your answer be different if we use PI method for evaluation ?

[PV of Rs. 1 using 10% interest rate over year 1 to 5 are 0.909, 0.826, 0.751, 0.683 and 0.621 respectively.]

[Ans. NPV Project X Rs. 60,870; Rs.9,394 and 1.04, Project X is preferable]

Q.8. Top management of X Ltd. proposes to invest Rs. 8,000 in a project which will give earnings for five years as under :

Year	1	2	3	4	5	Total
Rs.	3,000	4,000	3,000	2,000	2,000	14,000

Suggest whether this project is worthwhile to be taken up. You may take the rate of 10% as discounted rate of present value.

[Ans. P.V. Rs. 10,892 and N.P.V. 2,892 (positive). Project is worthwhile.]

Q.9. Project X initially costs Rs. 25,000. It generates the following cash flows :

Year	Cash Inflows	Present Value of Rs. 1 at 10%
1	Rs. 9,000	.909
2	8,000	.826
3	7,000	.751
4	6,000	.683
5	5,000	.621

Talking the cut-off rate as 10% suggest whether the project should be accepted or not.

[Ans. NPV Rs. 2,249, the project should be accepted]

Q.10. The following details relate to the two machine A & B :

	Machine A	Machine B
Initial Cost	1,12,250	1,12,250
Estimated Life	5 years	5 years



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Savage Value 6,000 6,000

Annual Income after tax & depreciation :

	(Rs.)	(Rs.)
Year 1	6,750	22,750
2	10,750	18,750
3	14,750	14,750
4	18,750	10,750
5	22,750	6,750

Overhauling charges at the end of 3rd year will be Rs. 20,000 in case of machine 'A' and Rs. 10,000 in case of machine 'B'. D had been charged at straight line method. Discounting rate is 10%. P.V.F. at 10% are :

Year	1	2	3	4	5
P.V.F.	0.909	0.826	0.751	0.683	0.621

Using Present Value Method, suggest which machine should be chosen.

[Ans. N.P.V. for Machine A Rs. 10,020; for Machine B Rs. 23,282.]

Q.11. A company is considering the following two investment projects :

	Cash Flows			
	Year 0	Year 1	Year 2	Year 3
A	(-) 10,000	(+) 7,500	(+) 7,500	-
B	(-) 10,000	(+) 2,000	(+) 4,000	(+) 12,000

Which project should be accepted and why ? Which method would you apply to evaluate the two projects and why ?

(PT) 2002]

[Ans. NPV A Rs. 3,012.50 B Rs. 4,134. Project B is better.]

Q.12. A choice is to be made between two competing projects which require an equal investment of Rs. 50,000 and are expected to generate net cash flows as under :

End of the year	Project I	Project II
1	25,000	10,000
2	15,000	12,000
3	10,000	18,000
4	Nil	25,000
5	12,000	8,000
6	6,000	4,000

The cost of capital of the company is 10%. Using discounted cash flow method, recommend which proposal is to be preferred ?

[Ans. NPV : Rs. 3,461 (I) Rs. 6,819 (II)

Project II is to be preferred]

Q.13. National Machinery Company is considering the purchase of new machine for Rs. 10,00,000. It has a life of 4 years and will realize Rs. 1,00,000 as salvage value at the end of fourth year. The machine will generate revenue of Rs. 20,00,000 per year and have variable cost of Rs. 16,00,000 per year. The cut-off rate is 10% and the tax rate is 40%. The PV factor @ 10% are as follows :

Year	1	2	3	4
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PVF @ 0.909 0.826 0.751 0.683
10%

Calculate :

(a) Net Present Value. (b) Traditional Pay-back Period.

[BBA - 2006]

[Ans. NPV Rs. 58,612.50; Pay Back Period 3.2 Years]

ACCOUNTING RATE OF RETURN

Q.14. Z Ltd. is contemplating an investment of Rs. 10,00,000 in a new plant, which will provide a salvage value of Rs. 80,000 at the end of its economic life of 5 years. The profits after depreciation and tax are estimated to be as under :

Table with 2 columns: Year, (Rs.)
1 50,000
2 75,000
3 1,25,000
4 1,30,000
5 80,000

Calculate the Accounting Rate of Return.

[Ans. A.R.R. = 20% Average Saving Rs. 92,000; Average Investments Rs. 4,60,000.]

Q.15. Kamal Ltd. has under consideration the following two projects, the details in respect of which are given below :

Table comparing Project A and Project B with rows for Cost of Investment, Working Capital, Economic Life, Salvage Value, Tax Rate, and Profit Before Depreciation and Tax for years 1-6.

You are required to calculate A.R.R. and suggest which project is to be preferred.

Ans. [A.R.R. : Project A 27.38%, Project B 26.73% (based on a average investment). Project A is to be preferred.]

INTERNAL RATE OF RETURN

Q.16. A project costs Rs. 16,000 and is expected to generate cash inflows Rs. 4,000 each for 5 years. Calculate the Internal Rate of Return.

[Ans. 8%]

Q.17. AA company is contemplating investment in a project which requires an initial investment of Rs.



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40,00,000 generating a cash flow of Rs. 16,000 every year for 4 years. Calculate the Internal Rate of Return.

[Ans. 22%]

Q.18. X Ltd. has currently under examination a project which will yield the following returns over a period of time :

Year	Gross Yield (Rs.)
1	80,000
2	80,000
3	90,000
4	90,000
5	75,000

Cost of the machinery to be installed works out to Rs. 2,00,000 and the machine is to be depreciated at 20% WDV basis. Income-tax rate is 50%. If the average cost of raising capital is 11%. Would you recommend accepting the project under IRR Method ?

[Ans. IRR 12.08% approx. The project may be accepted]

Q.19. Good luck Company Ltd. is considering two capital investment proposals, both requiring initial outlay of Rs. 10,000 each and have a life of Five years. The company pays tax @ 50% and arranges for depreciation on straight line basis. The cash inflows before depreciation and tax are as follows :

Year	1	2	3	4	5
Project 'A' (Rs.)	4,000	4,000	4,000	4,000	4,000
Project 'B' (Rs.)	6,000	3,000	2,000	5,000	5,000

Which project should be accepted according to Internal Rate of Return Method ?

[Ans. IRR Project A : 15.24%; B : 16.824%. Project B is better]

Q.20. A company is considering an investment proposal to install new milling controls. The project will cost Rs. 50,000. The facility has a life expectancy of 5 years and no salvage value. The company tax rate is 55%. The firm uses straight line depreciation. The estimated profit before tax from the proposed investment proposal are as follows :

Year	Profit
1	Rs. 10,000
2	Rs. 11,000
3	Rs. 14,000
4	Rs. 15,000
5	Rs. 25,000

Compute the following :

- a) Pay back period.
- b) Average rate of return.
- c) Internal rate of return.
- d) Net present value at 10% discount rate.
- e) Profitability index at 10% discount rate.



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[Ans. Pay back period 4.33 years; Average rate of return on average investment 9%; NPV Rs. -4,647; IRR of the project is 6.6% and PI is .907.]

MIX PROBLEM

Q21. A Company wants to replace the manual operations by New machine There are two alternatives models of P and Q of the New machine. Using payback period, suggest the most profitable Investment Ignore taxation.

	Machine-P	Machine-Q
Original Investment(Rs.)	9,000	18,000
Estimate life of the machine (Years)	4	5
Estimated saving in scrape (Rs.)	500	800
Estimated saving in wages (Rs.)	6,000	8,000
Additional cost of maintenance(Rs.)	800	1,000
Additional cost of supervision(Rs.)	1,200	1,800

[Machine P:2 yrs;Machine Q:3 yrs]

Q22. A company is considering an investment proposal to install new milling controls at a cost of Rs. 50,000.The expectancy of 5 yrs and no salvage value. The tax rate is 35 %.Assume the firm uses straight line depreciation and the same is allowed for tax purposes. The estimated cash flows before depreciation and tax (CFBT) from the investment proposals are as follows:

Year	CFBT
1	10,000
2	10,692
3	12,769
4	13,462
5	20,385

Compute the following: (i) Pay back period, (ii) Average rate of return (iii) Internal rate of return (iv) Net present value at 10% discount rate (v) Profitability index at 10% discount rate.

Q23. Malhotra Co. is considering investment in either one of the two alternative projects both with life of 5 years and the following information are given below:

	Project A (Rs.)	Project B (Rs.)
Capital investment—year0	1,00,000	80,000
Income year-1	30,000	40,000
year-2	30,000	35,000
year-3	30,000	30,000
year-4	30,000	25,000
year-5	30,000	10,000

The expected rate of return is 20% p.a.

The present value of Rs. 1/- at 20% from year 1 to 5 is as under

Year	1	2	3	4	5.
Present value	0.833	0.694	0.579	0.482	0.402

You are required to calculate the comparative Profitability of the; two projects by using Net Present Value method. [Net present value:: project A-(10,300); project B-11,050]

Q 24.The cost of a project is Rs. 13,550. Following amounts are expected to be received on a project: Iyr Rs. 2,000 IIyr Rs.4,000. ; IIIyr Rs.5,000. ; IVyr Rs.6,000. Find out their Net Present Values using 8% discount



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rate. Is it reasonable to invest in this project?
 [Yes; NPV:13,660]

Q25. The following details relate to the two machines X and Y :

	Machine X (Rs.)	Machine Y(Rs.)
Cost	56,125	56,125
Estimate life	5 years	5 years
Estimated salvage value	3,000	3,000
Annual Income after tax and depreciation:		
Year I	3375	11,375
Year II	5,375	9,375
Year III	7,375	7,375
Year IV	9,735	5,375
Year V	11,375	3,375

Overhauling charges at the end of 3 yrs Rs. 25,000 in cases Machine X .Depreciation has been charged at straight line method. Discount rate is 10% P.V.F. at 10% for five years are:

Year I II III IV V
 Approximate P.V.F. .909 .826 .751 .683 .621

Using Present value Method, suggest which machine should be chosen.

[Present value of Machine::X = 68,645 ; Y = 71,521]

Q26 . A large sized chemical company is considering investing in a project that costs Rs. 5,00,000.The estimated salvage value is zero ; tax rate is 35%.The company uses straight line depreciation for tax purposes and the proposed project has cash flows before tax(CFBT) as follows;

Year	CFBT
1	Rs. 1,00,000
2	1,00,000
3	1,50,000
4	1,50,000
5	2,50,000

Determine the following: (a) Pay-back period and (b) Average rate of return.

Q27. Determine the average rate to return from the following data of two machine A and B:

Original cost	56,125	56,125
+ Investment in Net working	5,000	6,000
Capital		
Estimated Life in a years	5	5
Average Income-tax rate	3,000	3,000
Estimated salvage value	55%	55%
Annual Estimated Income after Depr & Tax:		
1 st year	3,375	11,375
2 nd year	5,375	9,375
3 rd year	7,375	7,375
4 th year	9,375	5,375
5 th year.	11,375	3,375
	36,875	36,875

Depreciation has been charged on Straight line basis

[ARR:Machine::A=21.34%; B=20.74%]



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Q28. A choice is to be made between two competing projects, which require an equal investments Oof. 50,000 each and are expected to generate net cash flows as under:

	Project I (Rs.)	Project II (Rs.)
1.	25,000	10,000
2.	15,000	12,000
3.	10,000	18,000
4.	Nil	25,000
5.	12,000	8,000
6.	6,000	4,000

The cost of capital is 10% Using discounted cash flow method, d which project is to be preferred. Use P. V. F. as given in previous question. [N.P.V.: Project I=3,461 ; II=6,891]

Q29.From the following details relating to two projects, calculate the pay-back period and suggest which project is better:

	Project A (Rs.)	Project B (Rs.)
Cost of the project	1,80,000	2,00,000
Estimated scrape value	20,000	25,000
Estimated savings		
1 st year	25,000	35,000
2 nd year	30,000	50,000
3 rd year	45,000	70,000
4 th year	50,000	65,000
5 th year	40,000	30,000
6 th year	30,000	20,000
7 th year	10,000	---

better:

Q30. Consider the following proposed investment with the indicated cash inflows:

Investment	Initial outlay (Rs.'000)	Year-end Cash inflows(Rs.'000)		
		Year I	Year II	Year III
A	200	200	Nil	Nil
B	200	100	100	100
C	200	20	100	300
D	200	200	20	20
E	200	140	60	100
F	200	160	160	80

Rank the investments deriving the Net Present value(NPV)using a discount rate 10% and state your views. [NPV of Future cash inflows: Project A Rs. 181.80 , B Rs. 248.6 , C- Rs.326.08 , D-213.34 , E-Rs. 251.92 , F-Rs.337.68 F-should be preferred]



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Q31. A company is contemplating investment in a project which require an initial investment of Rs. 40,000 generating a cash flow of Rs. 16,000 every year for 4 year. Calculate the Internal Rate of Return. [Ans : 22%]

[Ans : 15%]

Q32. X ltd. has to Choose one of the following two mutually exclusive investment' Proposals. Both Proposals have to be depreciated on straight line method. The Tax rate may be assumed to be 50%. \The details are given below:

	Proposal I (Rs).	Proposal II (Rs).
Cost of investment	1,50,000	1,50,000
Cash inflows before tax		
Years 1	42,000	42,000
Years 2	48,000	45,000
Years 3	70,000	40,000
Years 4	80,000	50,000
Years 5	20,000	1,00,000

[Ans: P. B. P for: Proposal I - 2 Yrs. 108/13months; Proposal II - 2 yrs. 279/25 months.; Proposal I be accepted.]

Q33. MIs Kishan purchased a machine 6 years ago for. Rs. 4, 50,000 has been depreciated to a book-value of Rs. 2,70,000. It's economic life was 15 years with no salvage value. If this Machine is replaced a new machine costing Rs. 6,75, 000 the operating cost would be reduced by Rs. 90,000 for the Next 10 years, the old machine could also be sold for Rs. 1,50,000. The cost of capital is 10% The new machine will be depreciated on straight line basis over 8 years life with Rs. as salvage value. Tax rate is 55% Using Net Present Value Method and state whether the old machine should be replaced or not.

Q34. A co. Is producing articles mostly by manual labour and is considering to replace it by a new machine. There are two alternatives models X an Y of the new machine. Prepare a statement of profitability showing the pay-back period from the following information:

	Machine X	Machine Y
Estimated life of machine	4 years	5 years
Cost of machine	Rs. 18,000	Rs. 36,000
Estimated saving in scrape	1,000	1,600
Estimated saving in direct wages	12,000	16,000
Estimated cost of maintenance	1,600	2,000
Estimated cost of supervision	2,400	3,600
Ignore taxation		

[Ans. Pay-back Period machine X-2years, Machine Y-3 years. Company should prefer machine X]

Q35. A company wants to replace the manual operations by New Machine. There are two alternatives models of X and Y of the New Machine. Using Payback period, suggest the most profitable investment ignore Taxation.

	Machine X	Machine Y
Original Investment(Rs.)	9,000	18,00
Estimate life of the machine (Years)	4	5
Estimated saving in scrape (Rs.)	500	800
Estimated saving in wages (Rs.)	6,000	8,000
Additional cost of maintenance(Rs.)	800	1,000



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Additional cost of supervision(Rs.)	1,200	1,800
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[Ans. Pay-back Period machine X-2years.Macine Y-3years Investment in machine X is most profitable]

Q36. B co. is considering investment in either one of two alternatives projects with life of 5 yrs and the following information's are given [Ans. NPV: Project A (10,300),Project B 11,050,Project B is profitable.]

		Project A	Project B
Capital Investment	Year 0	1,00,000	80,000
Income	Year 1	30,000	40,000
	Year 2	30,000	35,000
	Year 3	30,000	30,000
	Year 4	30,000	25,000
	Year 5	30,000	10,000

Expected rate of return is 20% p.a. The present value of Rs.1 at 20% year 1 to 5 is under:

Year	1	2	3	4	5
Present	.883	.694	.579	.482	.402

Q37. A machine will cost Rs. 3,45,000 before it starts commercial production. At the end of its 4 years life its salvage value is estimated at Rs. 1,20,000, working capital required will be Rs. 65,000. Annual sales are estimated of Rs. 3,00,000, while the cost of sales, including depreciation will be Rs. 2,20,000.Is the proposal acceptable on quantitative consideration? The required rate of return of the firm is 10% after tax.

The firm pays tax on income @50% (PV. of1 @ 10% over 4 years is 0.683. while P.V. of 1 receive annually for 4 years is 3.17) [Ans. Present Value of cash inflow Rs. 4,31,467.50, Cash out flow Rs. 4,10,000. NPV 21,467.50. Proposal is acceptable]



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CASH FLOW STATEMENT (For The Year Ended....)

Particulars	Details	Amount
(I) CASH FLOW FROM OPERATING ACTIVITY		
Net Profit		
Add: Non operating expenses		
i) Depreciation		
ii) Goodwill written off		
iii) Preliminary expenses written off.		
iv) Loss from sale of machinery		
v) Discount on issue of shares / debentures		
vi) Premium on redemption of shares/debentures		
vii) Reserves / General reserves. (increase)		
viii) Provision for taxes.		
ix) Dividend		
x) Taxes paid.		
Less: Non operating incomes		
i) Appreciation		
ii) Goodwill raised		
iii) Profit on sale of machinery		
iv) Premium on issue of shares / Debentures		
v) Discount on redemption of shares / debentures.		
vi) Refund of taxes.		
vii) Reserve / General Reserve (Decrease)		
Operating Profit Before Working Capital Changes		
Add:		
Increase in liability-Decrease in asset (I. L. D. A) Current assets & Current Liabilities		
Less:		
Decrease in Liabilities-Increase in assets (D.L.I.A) Current assets & Current Liabilities		
Cash Flow from Operating Activity (Before Income Tax Paid)		
Less:		
Income Tax Paid		
NET CASH FLOW FROM OPERATING ACTIVITY		
(II) CASH FLOW FROM INVESTING ACTIVITY		
Purchase of fixed assets		
Sales of fixed assets		
Purchase of investments		
Sale of investments		
Interest received		
Dividend received		
NET CASH FROM/USED IN INVESTING ACTIVITIES		
(III) CASH FLOW FROM FINANCING ACTIVITIES		
Proceeds from issue of share capital		
Proceeds from long-term borrowing/banks		
Payment of long-term borrowings		



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Dividend paid		
NET CASH FROM/USED IN FINANCING ACTIVITIES (I + II + III)		
<i>Add-Cash and Cash Equivalents as at..... (Opening Balance)</i>		
<i>Less- Cash and Cash Equivalents as at(Closing Balance)</i>		
CASH FLOW FOR THE YEAR		



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Q.1 The following are the comparative balance sheets of ABC Ltd, as on 31st December 2003 and 2004.

Liabilities	2003	2004	Assets	2003	2004
Share Capital (Share of Rs. 10 each)	3,50,000	3,70,000	Land	1,00,000	1,50,000
Profit & Loss A/c	50,400	52,800	Stocks	2,46,000	2,13,500
9% Debentures	60,000	30,000	Goodwill	50,000	25,000
Creditors	51,600	59,200	Cash and Bank	42,000	35,000
			Temporary Investments	3,000	4,000
			Debtors	71,000	84,500
	5,12,000	5,12,000		5,12,000	5,12,000

Other particulars provided to you are : (a) dividends declared and paid during the year Rs. 17,500 (b) Land was revalued during the year at Rs. 1,50,000 and the profit on revolution transferred to profit and loss account. (c) Debentures redeemed at the end of year 2004. You are required to prepare a Cash Flow Statement for the ended 31.-12.2004..

Q.2 From the following balance sheets of Akash Company Limited as on December, 31, 2003 and 2004, you are required to prepare cash flow statement for the year ended December 31, 2004.

Liabilities	2003	2004	Assets	2003	2004
Share Capital	1,00,000	1,00,000	Goodwill	12,000	12,000
General Reserve	14,000	18,000	Building	40,000	36,000
Profit & Loss	16,000	13,000	Plant	37,000	36,000
Sundry Creditors	8,000	5,400	Investments	10,000	11,000
Bills Payable	1,200	800	Stock	30,000	23,400
Provision for Taxation	16,000	18,000	Bills Receivable	2,000	3,200
Provision for Doubtful Debts	400	600	Debtors	18,000	19,000
			Cash at Bank	6,600	15,200
	1,55,600	1,55,800		1,55,600	1,55,800

Additional Information :

- (i) Depreciation charged to plant Rs. 4,000.
- (ii) Provision for taxation of Rs. 19,000 was made during the year 2004.

Q.3 Given below are the Balance Sheets of V.R. Ltd. for the year ended 31st March 2004 and 2005.

Liabilities	31-3-04	31-03-05		31-03-04	31-03-05
Share Capital	2,25,000	3,00,000	Fixed Assets	1,57,500	2,40,000
General Reserve	1,35,000	1,47,000	Investment	1,20,000	1,95,000
P&L Appropriation A/c	40,200	60,750	Sundry Debtors	1,05,000	93,000
Mortgage Loan	-	90,000	Stock	67,500	93,000
Sundry Creditors	57,300	63,750	Cash	52,500	1,14,000
Provision for Taxation	45,000	73,500			
	5,02,500	7,35,000		5,02,500	7,35,000

Additional Information :

- (i) Depreciation charged during the year Rs. 31,500.
- (ii) Dividend paid during the year Rs. 22,500.



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- (iii) Provision for tax made during the year was Rs. 57,000.
 - (iv) investment costing Rs. 37,500 was sold for Rs. 42,000.
 - (v) Fixed assets costing Rs. 75,000 (Accumulated depreciation Rs. 30,000) was sold for Rs. 54,000.
- Prepare cash flow statement as per AS-3 using indirect method.

Q.4 Following are the comparative Balance Sheets of XYZ Ltd.

Liabilities	2004 Rs.	2003 Rs.	Assets	2004 Rs.	2003 Rs.
Share Capital	19,000	18,000	Land and Building	6,200	5,000
Profit and Loss Appropriation	3,500	2,900	Patent Rights	900	800
Trade Creditors & Bills Payable	7,600	6,400	Trade Debtors	19,000	15,500
			Cash	4,000	6,000
	30,100	27,300		30,100	27,300

Prepare a Statement of Cash Flow.

Q.5 The summarized Balance Sheets of Bharat Enterprises Ltd. as on 31st March are as under :

Capital & Liabilities	31-03-03	31-03-04	Assets	31-03-03	31-03-04
10% Pref. Share Capital	1,00,000	1,10,000	Machinery	2,00,000	2,30,000
Equity Share Capital	2,20,000	2,50,000	Buildings	1,50,000	1,76,000
Securities Premium	20,000	26,000	Land	18,000	18,000
Profit and Loss A/c	1,04,000	1,34,000	Stock	84,000	98,000
6% Debentures	70,000	64,000	Debtors	38,000	38,000
Creditors	38,000	46,000	B/R	42,000	62,000
Bills Payable	5,000	4,000	Cash	42,000	32,000
Provision for Tax	10,000	12,000			
Dividends Payable	7,000	8,000			
	5,74,000	6,54,000		5,74,000	6,54,000

You are required to prepare cash flow statement by Indirect Method (AS-3).

Q.6 The comparative Balance Sheets of a company are given below :

Liabilities	2003 Rs.	2004 Rs.	Assets	2003 Rs.	2004 Rs.
Share capital	35,000	37,000	Cash	4,500	3,900
10% Debentures	6,000	3,000	Book Debts	7,450	8,850
Creditors	5,180	5,920	Stock	24,600	21,350
Provision for Doubtful Debts	350	400	Land	10,000	15,000
Profit and Loss A/c	5,020	5,280	Goodwill	5,000	2,500
	51,550	51,600		51,550	51,600

Additional Information:

- (i) Dividends paid amounted to Rs. 1,750.
 - (ii) Land was purchased for Rs. 5,000 and amount provided for the amortization of goodwill amounted to Rs. 2,500.
 - (iii) Debentures were repaid to the extent of Rs. 3,000 at the end of the year 2004.
- You are required to prepare Cash Flow Statement as per AS-3 (Indirect Method).



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Q.7 From the following Balance Sheet of Bee Ltd. make out Cash Flow Statement :

Liabilities	2004 Rs.	2005 Rs.	Assets	2004 Rs.	2005 Rs.
Equity Share capital	3,00,000	4,00,000	Goodwill	1,15,000	90,000
8% Redeemable Preference Share	1,50,000	1,00,000	Land & Building	2,00,000	1,70,000
General Reserve	40,000	70,000	Plant & Machinery	80,000	2,00,000
Profit & Loss A/c	30,000	48,000	Debtors	1,60,000	2,00,000
Proposed Dividend	42,000	50,000	Stock	77,000	1,09,000
Creditors	55,000	83,000	Bills Receivable	20,000	30,000
Bills Payable	20,000	16,000	Cash balance	15,000	10,000
Provision for Tax	40,000	50,000	Bank Balance	10,000	8,000
	6,77,000	8,17,000		6,77,000	8,17,000

Additional Information's :

- Depreciation of Rs. 10,000 and 20,000 have been charged on Plant and Machinery and Land and Building respectively in the year 2005.
- Interim dividend of Rs. 20,000 has been paid in the year 2005. (C) Rs. 35,000 of Income Tax was paid during the year 2005.

Q.8 The following are the Balance Sheets of Evergreen Ltd.

	31-03- 2005 Rs.	31-03- 2004 Rs.
Plant & Machinery	2,80,000	2,00,000
Buildings	2,40,000	1,60,000
Investment	40,000	-
Receivables	2,00,000	2,80,000
Stock	1,60,000	80,000
Cash in Hand & at Bank	80,000	80,000
	10,00,000	8,00,000
Share Capital	4,00,000	3,20,000
Reserves	80,000	60,000
Profit & Loss A/c	40,000	24,000
6% Debentures	80,000	-
Provision for Tax	40,000	28,000
Proposed Dividend	80,000	40,000
Creditors	2,80,000	3,28,000
	10,00,000	8,00,000

Additional Information's:

- Depreciation @ 25% was charged on the opening value of Plant & machinery.
 - Building under construction was not subject to any depreciation .
 - Rs. 20,000 was paid as income-tax during the year.
 - An old machine costing Rs. 20,000 (W.D.V.Rs. 8,000) was sold for Rs. 14,000.
- Prepare Cash Flow Statement.

Ratio Analysis

Q.1 The following is the Balance Sheet of abc Ltd., for the year ending Dec 09

Liabilities	Rs.	Assets	Rs.
9% Preference Share	5,00,000	Goodwill	1,00,000



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Equity Share Capital	10,00,000	Land & Building	6,50,000
8% Debentures	2,00,000	Plant	8,00,000
Long-term Loan	1,00,000	Furniture & Fixture	1,50,000
Bills Payable	60,000	Bills Receivables	70,000
Sundry Creditors	70,000	Sundry Debtors	90,000
Bank Overdraft	30,000	Bank Balance	45,000
Outstanding Expenses	5,000	Short-term investments	25,000
		Prepaid Expenses	5,000
		Stock	30,000
	19,65,000		19,65,000

Calculate: (a) Current Ratio (b) Acid Test Ratio (c) Absolute Liquid Ratio

Long-term solvency ratios

Q.2 The following is the Balance Sheet of Maruti Ltd. , as on 30th June, 2008 :

Balance Sheet

Liabilities	Rs.	Assets	Rs
Equity Share Capital	3,00,000	Fixed Assets	6,00,000
9% Pref. Share Capital	1,00,000	Investment	50,000
Debentures	2,00,000	Current Assets	2,50,000
Reserves and Surplus	50,000		
Long-term Loans	25,000		
Current Liabilities	2,25,000		
	9,00,000		9,00,000

You are required to calculate:

Debt-Equity Ratio, Proprietary Ratio, Solvency Ratio, Fixed Assets to proprietors Funds Ratio, Fixed Assets Ratio, Current Assets to Proprietors Funds Ratio.

Q.3 Following is the profit and loss A/c of Fast and furious Ltd. For the year ended 31st December 2009:

Liabilities	Rs.	Assets	Rs.
To Opening Stock	1,00,000	By Sales	5,60,000
To Purchases	3,50,000	By Closing Stock	1,00,000
To Wages	9,000		
To Gross Profit c/d	2,01,000		
	6,60,000		6,60,000
To Administration expenses	20,000	By Gross Profit b/d	2,01,000
To Selling and Distribution Expenses	89,000	By interest on Investments	
To Non operating expenses	30,000	(Outside business)	10,000
To Net profit	80,000	By Profit on Sale of Investments	8,000
	2,19,000		2,19,000

You are required to calculate:

1. Gross Profit Ratio
2. Net Profit Ratio
3. Operating Ratio
4. Operating Profit Ratio
5. Administration Expenses Ratio.

Activity or turnover ratios

Q.4 The following information is given about TVS Ltd. for the year ending Dec. 31,2009

(i) Stock turnover ratio	6 times
(ii) Gross profit ratio	20% of sales



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(iii) Sales for 2009	Rs. 3,00,000
(iv) Closing stock is Rs. 10,000 more than the opening Stock	
(v) Opening creditors	Rs 20,000
(vi) Closing creditors	Rs 30,000
(vii) Trade debtors at the end	Rs 60,000
(viii) Net Working Capital	Rs 50,000

Find Out:

- (a) Average Stock
- (b) Purchases
- (c) Creditors

- (d) Average Payment Period
- (e) average Collection Period
- (f) Working Capital turnover Ratio

MIX PROBLEM

Q.5 The following is the Income Statement of good luck ltd. for the year ended 31st March 2009:

Net Sales			30,00,000
Less : Cost of Good Sold			
Opening Stock	5,00,000		
Add: Purchases	20,00,000		
	25,00,000		
Less : Closing Stock	7,00,000		18,00,000
Gross Profit			12,00,000
Less : Operating Expenses			4,80,000
Operating Profit			7,20,000
Less : Interest Charges			1,80,000
Profit before taxation			5,40,000

Additional information as on 31-3-2009:

Current Assets	9,75,000
Current Liabilities	6,00,000
Fixed Assets	5,25,000

From the above information as on 31-3-2009:

- (a) Operating ratio (b) Operating Profit Ratio (c) Stock Turnover Ratio
- (d) Assets Turnover Ratio (e) Return on Capital Employed.

Q.6 Following is balance Sheet of HTC Ltd. Mills Limited as on 31st, December, 2009:

	Rs.		Rs.
Liabilities		Assets	
Equity Share Capital	5,00,000	Fixed Assets 18,00,000	
12% Pref Share Capital	1,00,000	Less Dep. 5,00,000	13,00,000
Reserve Fund	4,00,000	Investment (short -term)	1,50,000
14% Debentures	7,00,000	Stock	3,00,000
Sundry Creditors	60,000	Book Debts	2,00,000
Bills Payable	1,00,000	Bank	50,000
Tax Provision	1,30,000		
Outstanding Expenses	10,000		
	20,00,000		20,00,000

(a) Net Sales	30,00,000	(b) Cost of Goods Sold	25,80,000
(c) Net Income before taxes	2,00,000	(d) Net Income after Ratio.	1,00,000



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You are required to calculate the following

- (i) Liquidity Ratio (ii) Proprietary Ratio (iii) Current Ratio
 (iv) Gross Profit Ratio and (v) Net Profit Ratio.

PRACTICE PROBLEMS

Q.7 From the following information of a Reliance Ltd. textile company, complete the proforma

Balance sheet if its sales are Rs 36,00,000.	
Sales/total assets	3
Sales /fixed assets	5
Sales /current assets	7.5
Sales / inventories	20
Sales / Debtors	15
Current ratio	2
Total assets / net worth	2.5
Debt/equity	1

Proforma Balance Sheet

Liabilities	Rs.	Assets	Rs.
Net worth	***	Fixed assets	***
Long term debt	***	Cash	***
Current debt	***	Inventories	***
		Sundry debtors	***
	***		***

Q.8 From the following information of a Bajaj Ltd. textile company, Complete the balance Sheet if its sales are Rs.32,00,000.

Sales to net worth	2.3 times
Current debt to net worth	42%
Total debt to net worth	75%
Current ratio	2.9 times
Net sales to inventory	4.7 times
Average collection period	64 days
Fixed assets to net worth	53.2%

Proforma Balance Sheet

Liabilities	Rs.	Assets	Rs.
Net Worth	***	Fixed Assets	***
Long term debt	***	Cash	***
Current debt	***	Stock	***
		Sundry debtors	***
	***		***

Q.9 From the following about a Big Bazar firm, Prepare its Balance -Sheet :

Total Debt to net worth	0.5 to 1
Turnover of total Assets	2
Gross Profit	30%
Average collection Period	40 Days



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Inventory turnover	3 times
Acid test ratio	0.75 to 1
Assume 360 days in year.	

Balance Sheet

Liabilities	Rs.	Assets	Rs.
Common Stock	2,00,000	Plant	?
Retained earnings	3,00,000	Inventory	?
Accounts Payable	?	Accounts receivable	?
		Cash	?

Q.10 Complete the following balance sheet of TATA Ltd.

Balance Sheet

Liabilities	Rs.	Assets	Rs.
Equity capital	3,00,000	Fixed Assets	?
Retained earnings	3,00,000	Inventory	?
Accounts Payable	?	Debtors	?
		Cash	?

Additional Information :

Total debt is two third of Net worth, turnover of total assets is 1.8,30 day sales are in the form of debtors, turnover of inventory is 5 cost of goods sold in a year is Rs 9,00,000, and the acid test ratio is 1:1.

Q.11 With the help of following information, Complete the balance Sheet of Mitsubishi Ltd.

Owner's equity	Rs 1,00,000
Current debt to total Debt	0.40
Total debt to owner equity	0.60
Fixed Assets to owner's equity	0.60
Total assets turnover	2 times
Inventory turnover	8 times

Q.12 Using the following data, complete the Balance Sheet of Walls Wagon Par Limited

Gross Profit	25% of sales
Gross profit	Rs 1,20,000
Shareholders equity	Rs 20,000
Credit sales to total sales	80%
Total turnover to total assets	4 times
Cost of sales to inventory	10 times
Average collection Period	5 days, assume 365 days in a year
Current Ratio	1.5
Sundry creditors	Rs 60,000

Balance Sheet

Liabilities	Rs.	Assets	Rs.
Share Capital	_____	Fixed Assets	_____
Long term debt	_____	Inventory	_____
Creditors	_____	Debtors	_____
		Cash	_____



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Q.13 Based on data given below prepare Balance Sheet of the Hyundai Ltd. company :

GP. Ratio (20%)	Rs 60,000
Shareholder's equity	50,000
Credit sales to total sales	0.80
Total assets turnover (times)	3
Inventory turnover (based on cost of sales)	8
Average collection period (360 day a year)	18
Current ratio	1.6
Long term debt to equity	0.40

Balance Sheet

Liabilities	Rs.	Assets	Rs.
Shareholder's equity	_____	Fixed Assets	_____
Long term debt	_____	Inventory	_____
Creditor's	_____	Debtors	_____
		Cash	_____

Q.14 Using the following Details, Prepare balance sheet of HP Ltd

Current Ratio	2.75
Acid ratio	2.25
Working capital	Rs 7,00,000
Reserve and surplus	Rs 1,00,000.
Total current assets included stock, debtors and cash only in the ratio of 2:6:3	
Total current liabilities included creditors and bills payable in the ratio of 3:2	
Fixed assets are 50% of share capital.	
The share capital is Rs 12,00,000. There are no other items of assets or liabilities.	

Q.15 The following incomplete balance sheet of M/s LNT and Co. is furnished together with certain additional information. You are required to complete the missing figures in the balance sheet using the Ratio-Analysis :

Balance Sheet of M/S Billu barber and Co. as

On 31st March, 09

Liabilities	Rs.	Assets	Rs.
Share capital	2,00,000	Fixed Assets	---
Reserves	1,00,000	P and M	---
Long Term Loan	_____	Current Assets :	
Creditors	1,00,000	Debtors	---
		Inventory	---
		Cash	_____

Additional Information :

- Ratio of Long Term Loan to net Worth 1:2
- Assets Turnover 2 Times
- Average Collection Period 36 days.
- Inventory Turnover 10 Times
- Gross Profit Margin 10% on cost of Goods Sold.
- Acid Test Ratio 1:1.
- Credit Sales 50%

Assume 360 days in a Year.



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Q.16 From the following information details of Barista, Prepare a Statement of Proprietary Funds :

a) Stock turnover	6
b) Capital turnover	2
c) Fixed assets turnover	4
d) Gross profit ratio	20%
e) Debtors turnover	2 Months
f) Creditors turnover	73 days

The gross profit was Rs. 60,000, Reserve and surplus amounted to Rs 20,000, Closing stock as Rs. 5,000 in excess of opening stock.

Q.17 From the following information about a Infosys Ltd. , Prepare its Balance Sheet :

Current Liabilities	1
Quick Ratio	1.5
Current Assets	2.5
Net Working Capital	Rs 3 Lakhs 2.5
Stock Turnover Ratio (Cost of Goods Sold/Closing Stock)	6 Times
Gross profit Ratio	20%
Fixed Assets Turnover Ratio (On cost of goods sold)	2 Times
Debt Collection Period	2 Months
Stock holders capital	5,00,000
Reserve and Surplus	2,50,000

Q.18 Avoidance company having a net working capital of Rs 2,80,000 indicates the following financial ratios and performance figures:

Current ratio	2.4
Liquidity ratio	1.6
Inventory turnover (on cost of sales)	8
Gross profit on sales	20%
Credit allowed (months)	15.

The company's fixed assets is equivalent to 90% of its net-worth (share capital plus reserves), while reserves amounted to 40% of share capital.

Q.19 Draw statement of Proprietor's Funds of DB Corps Ltd. :

Current ratio	2.5
Liquid ratio	1.5
Proprietary ratio (fixed Assets/ Proprietary funds)	0.75
Working capital	Rs 60,000
Reserve and Surplus	Rs 40,000
Bank Overdraft	Rs 10, 000
No long term loan or fictitious Assets	

Q.20 You are required to prepare a statement of Proprietor's fund from the following particulars :

Current ratio	2
Liquid Ratio	1.5
Proprietary ratio (Fixed Assets/ Proprietary Fund)	0.6
Working capital	Rs 60,000



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Reserve and Surplus	Rs 40,000
Bank Overdraft	Rs 10,000
No long term loan or fictitious Assets	

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