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शक्तिउत्थानआश्रमलखीसरायबिहार

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Accounting *Ratios H.W*

Short Answer Questions

Question 1:

What do you mean by Ratio Analysis?

ANSWER:

Ratio Analysis is a technique of financial analysis. It describes the relationship between various items of Balance Sheet and Income Statements. It helps us in ascertaining profitability, operational efficiency, solvency, etc. of a firm. It may be expressed as a fraction, proportion, percentage and in times. It enables budgetary controls by assessing qualitative relationship among different financial variables. Ratio Analysis provides vital information to various accounting users regarding the financial position and viability and performance of a firm. It also lays down the basic framework for decision making and policy designing by management.

Question 2:

What are the various types of ratios?

ANSWER:

Accounting ratios are classified in the following two ways.

I. Traditional Classification

II. Functional Classification

I. **Traditional Classification:** This classification is based on the financial statements, i.e. Profit and Loss Account and Balance Sheet. The Traditional Classification further bifurcates accounting ratios on the basis of the accounts to which the elements of a ratio belong. On the basis of accounts of financial statements, the Traditional Classification bifurcate accounting ratios as:

a. ***Income Statement Ratios***: These are those ratios whose all the elements belong only to the Trading and Profit and Loss Account, like Gross Profit Ratio, etc.

b. ***Balance Sheet Ratios***: These are those ratios whose all the elements belong only to the Balance Sheet, like Current Ratio, Debt Equity Ratio, etc.

c. ***Composite Ratios***: These are those ratios whose elements belong both to the Trading and Profit and Loss Account as well as to the Balance Sheet, like Debtors Turnover Ratio, etc.

II. **Functional Classification:** This classification reflects the functional need and the purpose of calculating ratio. The basic rationale to compute ratio is to ascertain liquidity, solvency, financial performance and profitability of a business. Consequently, the Functional Classification classifies various accounting ratios as:

a. ***Liquidity Ratio***: These ratios are calculated to determine short term solvency.

b. ***Solvency Ratio***: These ratios are calculated to determine long term solvency.

c. ***Activity Ratio***: These ratios are calculated for measuring the operational efficiency and efficacy of the operations. These ratios relate to sales or cost of goods sold.

d. ***Profitability Ratio***: These ratios are calculated to assess the financial performance and the financial viability of the business.