शक्तिउत्थानआश्रमलखीसरायबिहार

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Accounting *Ratios H.W*

Question 3:

What relationships will be established to study:

a. Inventory Turnover

b. Trade Receivables Turnover

c. Trade Payables Turnover

d. Working Capital Turnover
ANSWER:

a. **Inventory Turnover Ratio**: This ratio is computed to determine the efficiency with which the stock is used. This ratio is based on the relationship between cost of goods sold and average stock kept during the year.

$$\text{Inventory / Stock Turnover Ratio} = \frac{\text{Cost of Goods Sold}}{\text{Average Stock}}$$

$$\text{Cost of Goods Sold} = \text{Opening Stock} + \text{Purchases} + \text{Direct Expenses} - \text{Closing Stock}$$

$$\text{or, Cost of Goods Sold} = \text{Net Sales} - \text{Gross Profit}$$

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

b. **Debtors Turnover Ratio or Trade Receivables Turnover Ratio**: This ratio is computed to determine the rate at which the amount is collected from the debtors. It establishes the relationship between net credit sales and average accounts receivables.

$$\text{Debtors Turnover Ratio} = \frac{\text{Net Credit Sales}}{\text{Average Accounts Receivables}}$$

$$\text{Net Credit Sales} = \text{Total Sales} - \text{Cash Sales}$$

$$\text{Average Accounts Receivables} = \frac{(\text{Opening Debtors} + \text{Opening B/R}) + (\text{Closing Debtors} + \text{Closing B/R})}{2}$$

c. **Trade Payables Turnover Ratio**: This ratio is known as Creditors Turnover Ratio. It is computed to determine the rate at which the amount is paid to the creditors. It establishes the relationship between net credit purchases and average accounts payables.

$$\text{Payable Turnover Ratio} = \frac{\text{Net Credit Purchases}}{\text{Average Accounts Payable}}$$

$$\text{Net Credit Purchases} = \text{Total Purchases} - \text{Cash Purchases}$$

$$\text{Average Accounts Payable} = \frac{(\text{Opening Creditors} + \text{Opening B/P}) + (\text{Closing Creditors} + \text{Closing B/P})}{2}$$

d. **Working Capital Turnover Ratio**: This ratio is computed to determine how efficiently the working capital is utilised in making sales. It establishes the relationship between net sales and working capital.

$$\text{Working Capital Turnover Ratio} = \frac{\text{Net Sales}}{\text{Working Capital}}$$

$$\text{Net Sales} = \text{Total Sales} - \text{Sales Return}$$

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

Question 4:

The liquidity of a business firm is measured by its ability to satisfy its long-term obligations as they become due. What are the ratios used for this purpose?
ANSWER:

The liquidity of a business firm is measured by its ability to pay its long term obligations. The long term obligations include payments of principal amount on the due date and payments of interests on the regular basis. Long term solvency of any business can be calculated on the basis of the following ratios.

a. **Debt-Equity Ratio**- It depicts the relationship between the borrowed fund and owner's funds. The lower the debt-equity ratio higher will be the degree of security to the lenders. A low debt-equity ratio implies that the company can easily meet its long term obligations.

$$\text{Debt-Equity Ratio} = \frac{\text{Long-term Debt}}{\text{Equity/ Share holders Fund}}$$

b. **Total Assets to Debt Ratio**- It shows the relationship between the total assets and the long term loans. A high Total Assets to Debt Ratio implies that more assets are

financed by the owner's fund and the company can easily meet its long-term obligations. Thus, a higher ratio implies more security to the lenders.

$$\text{Total Assets to Debt Ratio} = \frac{\text{Total Assets}}{\text{Long-term Debt}}$$

c. **Interest Coverage Ratio**- This ratio depicts the relationship between amount of profit utilised for paying interest and amount of interest payable. A high Interest Coverage Ratio implies that the company can easily meet all its interest obligations out of its profit.

$$\text{Interest Coverage Ratio} = \frac{\text{Net Profit before Interest and Tax}}{\text{Interest on Long-term Loans}}$$