**UNIT-5**

**1.Accounting introduction?**

Accounting defined as it is a art of classifying, summarizing and interpreting the data.

Accounting is the system of recording financial transactions with both numbers and text in the form of financial statements. It provides an essential tool for billing customers, keeping track of assets and liabilities (debts), determining profitability, and tracking the flow of cash.

**Accounting Principles (or) concepts:**

**1. Business Entity Concept:**

Business entity concept is one of the accounting concepts that states that business and the owner are two separate entities and therefore, should be considered separate from each other.It helps in calculation of separate taxes for the business and its owners.

## 2. Money Measurement Concept:

Money measurement concept is an important accounting concept that is based on the theory that a company should be recording only those transactions that can be measured or expressed in monetary terms on the financial statement.

Money measurement concept is also known as Measurability Concept, which states that during the recording of any financial transactions, those transactions should not be recorded which cannot be expressed in terms of monetary value.

**3.Cost concept:** according to cost concept assets are recorded at the cost at which they are acquired. All transactions are recorded at their monetary cost of acquisition for example the price paid for acquiring an asset or receiving services.

**4.Realisation concept:** revenue is said to be recognised only when the sale is made, not when the sale proceeds are collected.in other words, the accountant does not usually revenue until it is considered to have been realised.

**5. Accounting period concept:** An accounting period is a span of time that covers certain accounting functions; it can be either a calendar or fiscal year, but also a week, month, or quarter, for example. Accounting periods are created for reporting and analyzing purposes, and the accrual method of accounting allows for consistent reporting.

**Ratio analysis?**

Ratio analysis is a quantitative procedure of obtaining a look into a firm’s functional efficiency, liquidity, revenues, and profitability by analyzing its financial records and statements. Ratio analysis is a very important factor that will help in doing an analysis of the fundamentals of equity.

Ratio analysis is a useful management tool that will improve your understanding of financial results and trends over time, and provide key indicators of organizational performance. Managers will use ratio analysis to pinpoint strengths and weaknesses from which strategies and initiatives can be formed.

**Objectives of Ratio Analysis are:**

* Simplify accounting information.
* Determine liquidity or Short-term solvency and Long-term solvency. Short-term solvency is the ability of the enterprise to meet its short-term financial obligations. Whereas, Long-term solvency is the ability of the enterprise to pay its long-term liabilities of the business.
* Assess the operating efficiency of the business.
* Analyze the profitability of the business.
* Help in comparative analysis, i.e., inter-firm and intra-firm comparisons.

**Types of Ratios:**

**1. Current Ratio:** The current ratio is the ratio between the current assets and current liabilities of a company. The current ratio is used to indicate the liquidity of an organization in being able to meet its debt obligations in the upcoming twelve months. A higher current ratio will indicate that the organization is highly capable of repaying its short-term debt obligations.

**Current Ratio = Current Assets / Current Liabilities**

**2. Quick Ratio:**The quick ratio is used to ascertain information pertaining to the capability of a company in paying off its current liabilities on an immediate basis.

**Quick Ratio = (Cash and Cash Equivalents + Marketable Securities + Accounts Receivables) / Current Liabilities. (OR)**

**Quick assets/ Current Liabilities**

**3.Inventory turnover ratio;**

Inventory turnover is the rate that inventory stock is sold, or used, and replaced. The inventory turnover ratio is calculated by dividing the cost of goods by average inventory for the same period.

**Inventory turnover ratio=cost of goods sold/average inventory**

**Where cost of goods sold=sales -gross profit**

**Average inventory=opening stock +closing stock**

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**Inventory holding period= 365 days**

**Inventory turnover ratio**

**4.Debtors turnover ratio:**

Accounts Receivables Turnover ratio is also known as debtor’s turnover ratio. This indicates the number of times average debtors have been converted into cash during a year. This is also referred to as the efficiency ratio that measures the company's ability to collect revenue.

**Debtors’ turnover ratio=credit sales /average debtors**

**Where average debtors=(opening balance of debtors +closing balance of debtors)/2**

**5.Gross profit ratio**

Gross profit ratio is the ratio between gross profit to sales during a given period.it is expressed in term of percentage. Gross profit is the difference between the net sales and the cost of goods sold.

**Gross profit ratio= (Gross profit/sales) \*100**

**6.Net profit ratio**

Net profit ratio is the ratio between net profits after taxes and net sales.it indicates what portion of sales is left to the owners after operating expenses

**Net profit ratio=(net profit after taxes/net sales)\*100**

**7.Return on investment**

Return on investment is one of the very important parameters affecting business plans. The profitability of the firm is measured in terms of return on investment.

.**Advantages of Ratio Analysis:**

* Ratio analysis plays an important role in analyzing a company’s financial performance. Therefore, the advantages of ratio analysis are:
* Useful tools for analysis for Financial Statements
* Simplifies accounting data
* Helpful in assessing the operating efficiency of business
* Useful for forecasting
* Useful in locating the weak areas
* Useful in inter-firm and intra-firm comparison

**Limitations Of Ratio Analysis**

* **Historical Information only considered**.
* **Inflationary effects**
* **Changes in accounting policies**
* **Operational changes accrued**
* **Seasonal effects**
* **Chances to Manipulation of financial statements.**