Problem on Journal, Ledger and Trial Balance:

Mr. X Started a business on 01.1.07, His transaction are as follows:

01.1.07	Started a business with a Capital of Rs. 10,00,000/-
05.1.07	Purchased Machinery Rs. 1,00,000/- in cash
10.1.07	Purchased Goods Rs. 20,000/-
15.1.07	Purchased Furniture from Mr. A Rs. 50,000/-
20.1.07	Goods from Mr B Rs. 10,000/-
25.1.07	Paid wages in cash Rs. 50,000/-
30.1.07	Opened a Bank Account depositing of Rs. 5,00,000/-
1.2.07	Paid rent by cheque of Rs. 5,000/-
5.2.07	Sold Goods for Rs. 30,000/-
10.2.07	Sold Goods to Mr. M Rs. 25,000/-
15.2.07	Received Cash from Mr. M Rs. 12,000/- and a cheque of Rs. 5,000/-
20.2.07	Allowed him discount of Rs. 1000/-
25.2.07	Cheque received from Mr. M sent to Bank
30.2.07	Paid Rs. 45,000/- to Mr. A in full settlement of his Dues by cheque.
1.3.07	Depreciation of Furniture Rs. 500/-
5.3.07	Paid Rs. 10,000/- to Mr. B in cash
10.3.07	Cheque received from M dishonoured
15.3.07	Mr. M is declared insolvent fully.
20.3.07	Invested Rs. 50,000/- in RBI Bond.
25.3.07	Received Interest Rs. 100/- by cheque.
30.3.07	A loan is taken from Mr. Q Rs. 50,000/-
1.4.07	Paid interest Rs. 500/- in cash.
5.4.07	Cash withdrawn from bank Rs 5000/-
10.4.07	Goods drawn by proprietor Rs 1000/-
15.4.07	Paid accounting charges Rs. 30,000/- to you

PROBLEMS ON TRIAL BALANCE

A. Prepare Trial Balance from the information given

1. Cash in hand Rs. 2,400; Capital Rs. 2,00,000, Purchases Rs. 2,40,000, Op. Stock Rs. 70,000 Debtors Rs. 1,00,000 , Bills payable Rs. 44,000, Plant & machinery Rs. 1,20,000, Creditors Rs. 48,000, Sales Rs. 4,00,000, Furniture Rs. 30,000, Bills receivable Rs. 40,000, Rent and taxes Rs. 20,000, Wages Rs. 32,000, Salaries Rs. 37,600

2. Plant & machinery Rs. 13,000 Capital Rs. 25,000, Buildings Rs. 17,000 Loans Rs. 5,000 Receivables Rs. 9,650, Purchases Rs. 18,000, Discount allowed Rs. 1,200 Sales Rs.35,000 Wages Rs. 7,000, Salaries Rs. 3,000, Travelling expenses Rs. 750 Accounts payable Rs.4,000 Freight Rs. 200, Insurance Rs. 300, Commission paid Rs. 100 Bills payable Rs. 5,000, Cash on hand Rs. 100, Bank Rs. 1,600 Purchase return Rs. 2,000, Repairs Rs. 500 Interest on loans Rs. 600, Opening Stock Rs. 6,000, Dividends received Rs. 3,000

3. Plant & machinery Rs. 1,20,000, Rent, rates & taxes Rs. 20,000 Sales Rs. 3,00,000 Sales returns Rs. 30,000, Freight Rs. 4,000, Accounts receivables Rs. 70,000 Purchase returns Rs. 10,000, Opening inventory Rs. 1,20,000 Bills payable Rs. 26,000 , Purchases Rs. 2,30,000 Discount paid Rs. 5,000, Interest on bank loan Rs. 5,000, Salaries Rs. 70,000 Accounts payable Rs. 40,000, Cash in hand Rs. 5,000, Legal charges Rs. 500 Bank loan1, Rs. 50,000, General expenses Rs. 8,000, Cash at bank Rs. 20,000, Capital Rs. 1, 81,500

4. Cash on hand Rs. 1,500 Sales Rs. 2,50,000 Returns outwards Rs. 2,000 , Cash at bank Rs. 3,000 Purchases Rs. 1,10,000 Returns inwards Rs. 1,500, Wages Rs. 20,000 Power and fuel Rs. 8,000 Carriage outwards Rs. 6,000, Carriage inwards Rs. 5,000Opening inventory Rs. 6,000Land Rs. 10,000, Buildings Rs. 80,000 Accounts payable Rs. 30,000,Machinery Rs. 30,000 Capital Rs. 56,000, Patents Rs.15,000 Accounts receivable Rs. 15,000 Salaries Rs. 12,000, Sundry expenses Rs. 6,000 Insurançe Rs. 1,000 Drawings Rs. 8,000,

5. Cash at bank Rs. 1,200, Office furniture Rs. 6,000, Accounts receivables Rs. 15,000 Commissions Rs. 1,200, Bills receivable Rs. 3,500, Power and fuel Rs. 6,000 Sales Rs. 1,50,300 Plant and machinery Rs. 24,000 Capital Rs. 27,000, Office expenses Rs. 2,000 Purchases Rs. 60,000 Carriage inwards Rs. 1,200 Rent received Rs. 3,500,Carriage outwards Rs. 3,500 Discount received Rs. 1,000, Rent, rates and taxes Rs. 1,700 Dividend received Rs. 2,000, Cash in hand Rs. 500, Leasehold premises Rs. 25,000 Accounts payable Rs. 12,000, Wages Rs. 30,000, Salaries Rs. 7,000 Bills payable Rs. 8,000, Opening inventory Rs. 12,000 Drawings Rs. 7,000, Sales returns Rs. 2,000 Purchase returns Rs. 5,000,

6 Opening inventory Rs. 72,000 Furniture Rs. 15,000 Purchases Rs. 2,25,000 Shayam Cr Rs. 24,000,Motor car Rs. 30,000 Ram Cr Rs. 32,000 Buildings Rs. 4,25,800 Kishore (Dr)Rs 20,000, Sanjay (Dr)Rs 12,000 Purchase returns Rs. 1,800 Raghav(Dr) Rs 18,000 Sales Rs. 3,50,000, Advertisement Rs.22,000 Repair and maintenance Rs.13,000 General expenses Rs.16,000, Insurance Rs.7,000 Capital Rs. 5,00,000 Cash in hand Rs. 3,500 Salaries Rs.30,000, Cash at bank Rs. 6,000 Commission Rs. 7,500

7. Plant & machinery Rs. 5,000 Office furniture and fittings Rs. 260 Op. Stock Rs. 4,800 Motor van Rs. 1,200 Discount Rs. 370 Sundry debtors Rs. 4,570 Cash in hand Rs. 40, Cash at bank Rs. 650 Returns outwards Rs. 550 Wages Rs. 15,000 Rent Rs. 600 Sales Rs. 48,000, Salaries Rs. 1,400

Reserves Rs. 250 Drawings 700 Sundry creditors Rs. 5,200, Purchases Rs 21,350 Bills receivable Rs. 720 R[illegible] Bills payal[illegible] Gene[illegible] d debt [illegible] Discount(Dr) Rs 650 Capital Rs. 4,000, Insurance Rs 630 Factory Rent [illegible]80

8. Opening stock Rs 46,000, 12% Bank loan (taken on 1st Nov 1993) Rs 1,50,000 Purchases Rs 4,42,000 Sundry creditors Rs 40,000 Wages Rs 43,500 Salaries Rs 66,000 Sales returns Rs 8,000 Carriage outwards Rs 12,000 sales Rs 8,20,000 Capital account Rs 4,76,900 Carriage inwards Rs 39,100 Advertising expenses Rs 10,200 Sundry Debtors Rs 45,000 Bills receivable Rs 9,000 Furniture Rs. 2,00,000 Bad debts Rs 800 Office equipment Rs 1,99,700 Land & building Rs 3,36,000, Rates and taxes Rs 5,300, Office electricity expenses Rs 9,400 Telephone charges Rs 4,400 , Cash at Bank Rs 18,000 Bills payable Rs 10,000, Printing & stationery Rs. 11,200 , Postage stamps Rs 1,090 [illegible] Rs 1,700 . Petty cash Rs 210 Discount received Rs 2,200 ,Prepaid printing Rs 1,200 Interest on Bank loan paid Rs 1,500, Insurance premium Rs 3,000 purchase returns Rs 12,000 Reserve Rs 3,200

9. Shri Govind's capital Rs. 2,28,000, Shri Govind's drawing Rs 13,200, Plant and machinery Rs 99,000, Freehold property Rs 66,000 ,Purchases Rs 1,10,000, Returns outwards Rs 1,100 ,Salaries Rs 13,200 , Office expenses Rs 2,750, Office furniture Rs 5,500, Discount A/c (Dr) Rs 1,320 ,Sundry debtors Rs 29,260 ,Loan to Shri Krishna @ 10% p.a. balance on 1.4.94 Rs 44,000, Cash at bank Rs 29,260, Bills payable Rs 5,500, Sales Rs 2,31,440 ,Stock 1.4.94 Rs 38,500 ,Wages Rs 35,200, Sundry creditors Rs 44,000 ,Postage & Telegrams Rs 1,540 ,Insurance Rs 1,760 ,Gas and fuel Rs 2,970, Bad debts Rs 660, Office rent Rs 2,860, Freight Rs. 9,900 ,Loose tools Rs. 2,200 ,Factory lighting Rs. 1,100 ,Reserve Rs. 880 ,Interest on loan to Shri Krishna Rs 1,100 ,Cash in hand Rs 2,640

10. Capital Rs 1,00,000 ,Furniture Rs. 20,000 ,Purchases Rs 1,50,000 ,Debtors Rs 2,00,000 Interest earned Rs 4,000 ,Salaries Rs 30,000 Reserves Rs 8,000, Wages Rs. 20,000, Rent Rs 15,000 Creditors Rs. 1,20,000 ,Sales return Rs 10,000 ,Bad debt written-off Rs. 7,000 Sales Rs 3,21,000, Drawings Rs. 24,000 ,Printing and Stationery 8,000 Purchase returns Rs. 5,000, Insurance Rs. 12,000 ,Opening stock Rs. 50,000 ,Office expenses Rs. 12,000

PROBLEMS ON TRADING AND PROFIT & LOSS ACCOUNT AND BALANCE SHEET

1. From the trial balance prepared in 1 above , prepare a Trading And Profit & Loss Account and Balance Sheet, considering the following adjustments

   1. Closing Inventory Rs 50,000
   2. Outstanding wages Rs 5,000
   3. Depreciation on plant and machinery at 10 at per cent and furniture at 5 per cent

2. From the trial balance prepared in 2 above , prepare a Trading And Profit & Loss Account and Balance Sheet, considering the following adjustments

   1. Closing inventory, Rs. 8,000
   2. Depreciation on plant and machinery at 15 per cent and 10 per cent on buildings.
   3. Insurance prepaid Rs. 50

4. Outstanding rent, Rs. 100

3. From the trial balance prepared in 3 above, prepare a Trading And Profit & Los Account and Balance Sheet, considering the following adjustments

1. Interest on bank loan outstanding Rs. 7,000
2. Closing inventory Rs. 1,20,000

4. From the trial balance prepared in 4 above, prepare a Trading And Profit & Loss Account and Balance Sheet, considering the following adjustments

1. Closing inventory Rs. 20,000
2. Outstanding salaries Rs. 5,000 outstanding wages Rs. 3,000
3. Depreciation @ 10 per cent on all assets.

5. From the trial balance prepared in 5 above, prepare a Trading And Profit & Loss Account and Balance Sheet, considering the following adjustments

1. Closing inventory Rs. 18,000
2. Depreciate plant and machinery at 10 per cent
3. Salaries outstanding Rs. 1,000 power and fuel outstanding Rs. 2,000
4. Rs. 5,000 was spent on plant and machinery but wrongly included under wages
5. Commission due Rs. 200.
6. Rent received includes Rs. 500 received in advance.

6. From the trial balance prepared in 6 above, prepare a Trading And Profit & Loss Account and Balance Sheet, considering the following adjustments

1. Closing inventory Rs. 80,000
2. Prepaid advertisement Rs 2,000
3. Goods used for domestic purpose, Rs. 1,000
4. Outstanding salaries, Rs. 3,000
5. Depreciation on buildings at 5 per cent, furniture 5 per cent and motor car at 10 per cent

7 From the trial balance prepared in 7 above, prepare a Trading And Profit & Loss Account and Balance Sheet, considering the following adjustments

1. Stock Rs. 5,200
2. 3 months factory lighting and heating is due, but not paid Rs. 30
3. 5% depreciation to be written-off on furniture.
4. Write-off further bad debts Rs. 70
5. During the year machinery was purchased for Rs. 2,000 but it was debited to Purchases Account

8. From the trial balance prepared in 8 above, prepare a Trading And Profit & Loss Account and Balance Sheet, considering the following adjustments

a) Closing stock was valued at Rs. 38,000
b) Goods worth Rs. 2,500 were distributed by salesmen as free samples, but no entry has been made for this
c) Depreciate furniture by 7 ½ % p.a. and office equipment by 10% p.a.

d) Commission duef Rs 1,300
e) Rates and taxes of Rs 800 was paid in advance for 1994
f) Creditors include a debt of Rs 4,000 to Mr Nayak who is also included in the list of Debtors for Rs 5,000 and therefore, to be set off

9 From the trial balance prepared in 9 above, prepare a Trading And Profit & Loss Account and Balance Sheet, considering the following adjustments

1. Cl Stock was valued at Rs 72,600
2. A new machine was installed during the year costing Rs 15,400 but it was not recorded in the books as no payment was made for it. Wages Rs 1,100 paid for its erection have been debited to wages account.
3. Depreciate Plant by 33 1/3%; Furniture by 10% and Freehold property by 5%.
4. Closing Loose tools were valued at Rs 1,760
5. Of the sundry debtors Rs 660 are bad and should be written-off

10 From the trial balance prepared in 10 above, prepare a Trading And Profit & Loss Account and Balance Sheet, considering the following adjustments

1. Depreciate furniture by 10% on original cost
2. Salaries unpaid Rs. 3,000. However salaries included Rs 2,000 paid in advance
3. Insurance prepaid Rs 2,000
4. Provide for outstanding office expenses Rs 8,000
5. Stock used for private purpose Rs 6,000
6. Closing stock-in-trading Rs 60,000

1.1 INTRODUCTION

Role and responsibilities of a finance manager have under gone a remarkable transformation during the last four decades. Unlike the past, finance manager plays pivotal role in planning the quantum and pattern of fund requirements, procuring the desired amount of funds on reasonable terms, allocating funds so pooled among profitable outlets and controlling the uses of funds. Since all business activities involve planning for and utilization of funds, finance manager must have clear conception of the financial objectives of his firm and cardinal principles of financial decisions. Against this back drop, we shall discuss the basics of financial decisions; nature of long term financing and investment decisions; NPV Rule; time value of money; determination of implied interest rates, implied principal amount and annuities and basic factors influencing long term financial decisions.

1.2 NATURE OF FINANCIAL DECISIONS

Financial decisions refer to decisions concerning financial matters of a business concern. Decisions regarding magnitude of funds to be invested to enable a firm to accomplish its ultimate goal, kind of assets to be acquired, pattern of capitalization, pattern of distribution of firm's, income and similar other matters are included in financial decisions. A few specific points in this regard are

(a) Financial decisions are taken by a finance manager alone or in conjunction with his other management colleagues of the enterprise.

(b) A finance manager is responsible to handle all such problems as involve financial matters.

(c) The entire gamut of financial decisions can be classified in three broad categories: Investment Decisions, Financial Decisions and Dividend Policy Decisions.

1.2.1 Investment Decisions

Investment decisions, the most important financial decision, is concerned with determining the total amount of assets to be held in the firm, the make-up of these assets and the business risk complexion of the firm as perceived by the investors. The salient features of investment decisions are as follows:

(i) The investment decision are of two types, viz, long term investment decisions and short term investment decisions.

(ii) Long term investment decision decides about the allocation of capital to investment projects whose benefits accrue in the long run. It is concerned with deciding :

- What capital expenditure should the firm make?
- What volume of funds should be committed?
- How should funds be allocated as among different investment opportunities?

(iii) Short terms investment decision decides about allocation of funds as among cash and equivalents, receivables and inventories.

(iv) A firm may have a number of profitable investment proposals in hand. But owing to paucity of funds, finance manager should be meticulous in choosing the most profitable one.

(v) Thrust of financial decisions is on building suitable asset mix.

1.2.2 Financing Decision

In Financing decision, finance manager has to decide about the optimal financing mix. It is concerned with how to raise money for business so as to maximize value of the firm. Highlights of financing decisions are as follows:

(i) Question of making financing decision arise as soon as decision regarding investment outlets is made. At times investment decision follows financing decision.

(ii) A finance manager has to decide the appropriate mix of debt and equity in such a way that wealth of the shareholders is maximized.

(iii) A finance manager is supposed to delve into the following issues requiring financing decisions:

(a) From which sources are funds available?

(b) To what extent are funds available from these sources?

(c) What is the cost of funds presently used?

(d) What is the expected cost of future financing?

(e) What instruments should be employed to raise funds and at what time?

(f) Should firm approach financial institutions for securing funds?

(g) What will be the terms and conditions on which the funds will be raised from different sources?

(h) What will be the nature of underwriting arrangements?

(i) What innovations can be made in raising funds from wide variety of sources?

(iv) A finance manager has to be in constant touch with financial markets.

(v) Financing decisions are primarily concerned with capital structure or debt equity compositions.

1.2.3 Dividend Policy Decision

Dividend policy decision decides about allocation of business earnings between payment to shareholders and retained earnings. A part of the profits is distributed amongst shareholders and other part is retained for growth of the company. A few specific points in this regard are as follows:

(i) Closely related to the issue of raising finance is the issue of distribution of profits, which is effectively a source of total fund requirements. This constitutes the area of dividend decisions.

(ii) Although both growth and dividends are desirable, these two goals are conflicting: a higher dividend rate means less retained earnings and consequently, a slower rate of growth in earnings and stock prices.

(iii) For maximizing the shareholder's wealth, the finance manager has to strike a satisfactory compromise between the two

(iv) Prudent finance manager takes dividend decision in the light of investor's preferences, liquidity position of the firm, stability of earnings of the firm, need to repay debt, restrictions in debt contracts, access to capital markets etc.

(v) Dividend policy decision is integral part of financing decisions.

1.2.4 Inter-relationship Amongst these Decisions

The interrelationship between three types of financial decisions centres around the following issues:

(a) Which decision comes first investment or financing?

One often wonders whether the financing decision comes first or the investment decision e difficulty with such a question is that any answer in favour of the one r is bound to be wrong. For example, why would any m ... o raise any capital unless it had some kind of ... already ... . Alternatively, how can a management consider undertaking a new project unless it already had some ideas as to how it is going to raise the necessary finances? So how does one decide which comes first? Chicken or the egg? The answer in our context is somewhat simpler than the moot question concerning the egg and its parent. The two decisions are in reality simultaneous. In fact neither decision by itself makes sense without the other. There would be no financing decisions to make in the absence of investment decisions and vice versa.

(b) Investment Decision Vs Financing Decision- Fundamental Difference

This, however, is not to imply that the line dividing the two is fuzzy. In fact, conceptually the two kinds of decisions are quite different and it is important to recognize them as such. What is the fundamental difference between the two ? Evidently, both, financing as well as investment decisions involve a certain selection of cash flows. Typically, a financing decision involves accepting cash today (inflows) from the capital market and repaying the same together with interest or dividend subsequently over a period of time (outflows). On the other hand, an investment decision involves investing the cash today in the product market (outflow) and receiving a stream of earnings (inflows) subsequently. Now, the cash invested in the product market is, in fact, the cash which is raised from the capital market.

(c) Relationship through NPV

If after paying all lenders their interest and shareholders their normally expected dividends, some surplus is left, obviously, it will belong to the shareholders thereby increasing their wealth. Usually, however, it is extremely cumbersome, though not impossible, to match the cash flows arising from the financing decisions and the cash flows accruing from the investment decisions on a period basis on account of the possible mismatch between their timings. It is therefore far simpler to capture the financing cash flows through their cost (of capital and to use this rate for discounting the operating cash flows. Under this framework, obtaining a positive net present value (NPV) implies the same thing as minimizing the cost of capital. The point becomes further clear if we take another look at the NPV formula i.e.

$NPV=Co+C_1/(1+r)$ where C_0 and C_1 are cash flows occuring at time 0 and 1

A close look into the formula would readily show that 'r' and NPV are inversely related. A higher 'r' would mean lower NPV and vice versa. The 'r' being the rate of discount which normally represents cost of capital. It clearly highlights the interlinkage between the financing and the investment decisions and provides an explicit justification of the NPV rule as the basic rule of financial decision making.

Activity 1

(a) Identify forces than brought about fundamental change in role and responsibilities of a finance manager in India.

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(b) Write down two sets of cash flows; one representing a financing scheme and the other an investment scheme.

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