

Victoria University Of Bangladesh

Course title ~ ACT 110

Bachelor of Tourism & Hotel Management

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1.

(i)

The current ratio is a financial metric used to evaluate a company's ability to pay its short-term obligations with its short-term assets. It is calculated by dividing a company's current assets by its current liabilities.

Formula:

Current Ratio

=

Current Assets

Current Liabilities

Current Ratio=

Current Liabilities

Current Assets

Interpretation:

A ratio greater than 1 indicates that a company has more current assets than current liabilities, suggesting it can meet its short-term obligations comfortably.

A ratio of less than 1 indicates that a company may have difficulty meeting its short-term obligations with its current assets alone.

While a higher current ratio generally indicates better short-term liquidity, excessively high ratios may suggest inefficient use of resources, as cash may be sitting idle instead of being invested in growth opportunities.

Usage:

Investors and creditors often use the current ratio to assess a company's short-term liquidity and financial health.

It's important to consider industry norms and the company's specific circumstances when interpreting the current ratio, as different industries may have different typical ratios.

2.(ii)

The debt to equity ratio is a financial metric used to assess a company's financial leverage by comparing its total liabilities to its shareholders' equity. It indicates the proportion of debt financing relative to equity financing used by a company to finance its assets.

Formula:

Debt to Equity Ratio

=

Total Debt

Shareholders' Equity

Debt to Equity Ratio=

Shareholders' Equity
Total Debt

Interpretation:

A higher debt to equity ratio indicates that a company relies more on debt financing than on equity financing. This can magnify returns on equity but also increases financial risk.

A lower debt to equity ratio suggests a conservative approach, with more reliance on equity financing. While this reduces financial risk, it may also limit potential returns.

Usage:

Investors use the debt to equity ratio to assess a company's financial risk and its ability to meet its debt obligations.

Creditors use it to evaluate the company's creditworthiness and the likelihood of repayment.

It's essential to compare the debt to equity ratio within the same industry, as different industries have varying norms for acceptable levels of leverage.

Considerations:

High debt to equity ratios aren't necessarily negative if the company can generate higher returns with borrowed funds than the cost of borrowing.

Conversely, low ratios aren't always positive; excessively low leverage might indicate missed growth opportunities. The debt to equity ratio is just one of many metrics used to evaluate a company's financial health and should be considered alongside other factors.

2.

Cash Flow Statement:

A cash flow statement is a financial statement that provides an overview of the cash inflows and outflows of a business during a specific period. It helps stakeholders understand how cash moves in and out of a company, providing insights into its liquidity, operational efficiency, and financial health.

Steps of a Cash Flow Statement:

Operating Activities:

This section records cash inflows and outflows related to the company's primary business operations.

Cash receipts from sales, interest, and dividends received are included as inflows.

Cash payments for operating expenses, salaries, and taxes are recorded as outflows.

Non-cash items such as depreciation and changes in working capital are adjusted to reflect their impact on cash.

Investing Activities:

This section accounts for cash transactions involving the purchase and sale of long-term assets, investments, and other non-current assets.

Cash inflows from the sale of property, plant, and equipment or investments are recorded.

Cash outflows for the acquisition of new assets or investments are subtracted.

Financing Activities:

This section reflects cash flows related to the company's financing activities, including borrowing, issuing equity, and paying dividends.

Cash inflows from issuing new shares or borrowing through loans or bonds are recorded.

Cash outflows for dividends paid to shareholders, repayment of loans, or repurchasing shares are accounted for.

Net Cash Flow:

The cash flows from operating, investing, and financing activities are summed to calculate the net cash flow for the period.

Positive net cash flow indicates more cash coming into the business than going out, while negative net cash flow indicates the opposite.

Beginning and Ending Cash Balance:

The net cash flow is added to the beginning cash balance to determine the ending cash balance for the period.

The ending cash balance represents the amount of cash and cash equivalents the company holds at the end of the period.

By presenting cash flows from operating, investing, and financing activities, the cash flow statement provides stakeholders with a comprehensive view of how a company generates and uses cash, aiding in decision-making and financial analysis.

