

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.