5th semester B. Com computer application and cooperation

ACCOUNTING FOR MANAGEMENT

Study material

Chapter 1

Introduction to accounting for management

Summary Definition

**Define Management Accounting:** Management accounting means

analysing and recording business activities for internal company use in an

effect to increase efficiency and productivity.

**I**nstitute of Chartered Accountants of England and Wales defines management accounting as:

Any form of accounting which enables a business to conduct more efficiently can be regarded as Management Accounting.

American Accounting Association defines management accounting as:

Management Accounting includes the methods and concepts necessary for effective planning, for choosing among alternative business actions, and for control through the evaluation and interpretation of performance.

Characteristics of Management Accounting

Management accounting provides data to the management on the basis of which they take decisions to achieve organizational goals and improve their efficiency. In this section, we will discuss the main characteristics of management accounting.

To Provide Accounting Information

Information is collected and classified by the financial accounting department, and presented in a way that suits managerial needs to review the various policy decisions of an organization.

Cause and Effect Analysis

One step further from financial accounting, management accounting works to know the reasons of profit or loss of an organization. It works to find out the causes for loss and also study the factors which influence the profitability. Therefore, cause and effect is a feature of management accounting.

Special Technique and Concepts

Budgetary control, marginal costing, standard costing are main techniques used in financial accounting for successful financial planning and analysis, and to make financial data more useful.

Decision Making

Studying various alternative decisions, studying impact of financial data on future, supplying useful data to management, helping management to take decisions is a part of management accounting.

Achieving Tasks

Financial data is used to set targets of the company and to achieve them. Corrective measures are used if there is any deviation in actual and targeted task. This all is done through management accounting with the help of budgetary control and standard costing.

No Fixed Norms

No doubt, tools of management accounting are same, but at the same time; uses of these tools depend upon need, size, and structure of any organization. Thus, no fix norms are used in application of management accounting. On the other hand, financial accounting totally depends on certain rules and principals. Therefore, presentation and analysis of accounting data may vary from one organization to another.

Increasing Efficiency

While evaluating the performance of each department of an organization, management accounting can spot the efficient and inefficient sections of an organization. With the help of that, corrective step can be taken to rectify the inefficient part for better performance. Hence, we can say that efficiency of a concern can increase using accounting information.

Informative Instead of Decision Making

Decisions are taken only by top management using information provided by management accountant as classified in a manner which is useful in decision making. Decision making does not come under preview of accountant, it is only the top management, who can take decision. Thus, decision of an organization depends on caliber and efficiency of the management.

Forecasting

Management accountant helps management in future planning and forecasting using historical accounting data.

Objectives of Management Accounting

Let us go through the objectives of management accounting:

Planning and Formulating Policies

In the process of planning and formulating policies, a management accountant provides necessary and relevant information to achieve the targets of the company. Management accounting uses regression analysis and time series analysis as forecasting techniques.

Controlling Performance

In order to assure effective control, various techniques are used by a management accountant such as budgetary control, standard costing, management audit, etc. Management accounting provides a proper managerial control system to the management. Reports are provided to the management regarding the effective and efficient use of resources.

Interpreting Financial Statement

Collecting accounting data and analyzing the same is a key role of management accounting. Management accounting provides relevant information in a systematic way that can be used by the management in planning and decision-making. Cash flow, fund flow, ratio analysis, trend analysis, and comparative financial statements are the tools normally used in management accounting to interpret and analyze accounting data.

Motivating Employees

Management accounting provides a selection of best alternative methods of doing things. It motivates employees to improve their performance by setting targets and starting incentive schemes.

Making Decisions

Success of any organization depends upon accurate decision-making and effective decision-making is based on informational network as provided by management accounting. Applying techniques of differential costing, absorption costing, marginal costing, and management accounting provides useful data to the management to aid in their decision-making.

Reporting to Management

It is the primary role of management accounting to inform and advice the management about the latest position of the company. It covers information about the performance of various departments on regular basis to the management which is helpful in taking timely decisions.

A management accountant also works in the capacity of an advisory to overcome any existing financial or other problems of an organization.

Coordinating among Departments

Management accounting is helpful in coordinating the departments of an organization by applying thorough functional budgeting and providing reports for the same to the management on a regular basis.

Administrating Tax

Any organization must comply with the tax systems prevailing in the country they are operating from. It is a challenge due to the ever-increasing complexity of the tax structure. Organization need to file various kinds of returns with different tax authorities. They need to calculate the correct amount of tax and assure timely deposit of tax. Therefore, the management takes guidance from management accountants to comply with the law of the land.

**How is Management accounting different from Financial accounting?**

Financial accounting and management accounting have some inherent differences. They are

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| **Basis for Comparison** | **Management accounting** | **Financial accounting** |
| Purpose | It is used for internal purpose | It is used for external reporting primarily,  although the management also reviews it |
| Regulation | It is not regulated by any law | It has to be presented as per standards |
| Users | Its users are the management of an organization | Its users are shareholders, investors and regulators |
| Objective | It aids in internal decision making | It aids in investment decision by outsiders and  monitoring by regulators |
| Mandatory | Preparation and presentation of financial statements is not mandatory | Preparation and presentation is mandatory. |
| Audit | It is not subject to audit | Financial statements must be audited |
| Frequency | There is no defined frequency for preparation and presentation of the statements | Financial statements must be prepared for the  financial year and presented |
| Contents | Management accounts include both monetary and non-monetary information | Financial accounts include only monetary information |

**What are the benefits of Managerial accounting?**

**Management accounting is very beneficial and hence is being used widely now.  The benefits are as follows:**

* **Planning**

**In management accounting, the financial information and non financial information is presented at regular intervals say weekly,  fortnightly to the management. This presentation includes forecasts, budgets and in-depth analysis. Hence it assists the management in planning the business activities.**

* **Decision making**

**Since management accounting presents various charts,  forecasts and analysis the management uses it for decision making.**

* **Identify early signs of problems**

**If a product is not performing well the management can identify it early on as the accounts are presented at regular intervals. This will aid in overcoming the constraints early on and avoiding future losses.**

* **Strategic management**

**Based on the information presented in management accounting, the management can take decisions about continuing a product or modifying the sale strategy. Since management accounting is not regulated by any law,  the management can decide the areas that require more analysis, investigation and accordingly draw up strategies.**

**Functions of managerial accounting**

**Managerial accounting performs the following functions in general**

* **Profitability**

**Management accounting determines the profit from a particular product,  project or line of business.**

* **Break even analysis**

**It determines the number of units at which the organization will attain a no profit no loss situation.**

* **Forecasting**

**It determines the bottlenecks in the organization and their impact on the organization.**

* **New product analysis**

**It prepares analysis for the new product in terms of standard costs,  actual cost and reasons for deviations.**

* **Stock valuation**

**Determine the direct and indirect costs of stock in hand and presenting it to management**

* **Variance analysis**

**Performing trend analysis for various costs incurred and understanding the causes for the variances.**

* **Capital budgeting analysis**

**Understanding the need for acquiring fixed assets and the costs involved and allocation of finances to the best available option.**

* **Aids in Financial accounting**

**Management accounting presents financial information at regular intervals and hence it aids in the preparation of financial statements at year-end.**

**Just as automation has touched every aspect of business so also ERP systems enable reporting under management accounting. The various functions of management accounting like capital budgeting,  variance analysis, profitability are performed by ERP systems and reports are generated. The management accountant has to ensure correctness of the information inputted and reports generated.**

**Management accounting provides the management with better control of the business. Although not regulated by any law it provides the management an assurance. It provides the management the confidence to face auditors and regulators. It aids in better management.**

DIFFERENCE B/W MANAGEMENT ACCOUNTING & COST ACCOUNTING

Management accounting collects data from cost accounting and financial accounting. Thereafter, it analyzes and interprets the data to prepare reports and provide necessary information to the management.

On the other hand, cost books are prepared in cost accounting system from data as received from financial accounting at the end of each accounting period.

The difference between management and cost accounting are as follows:

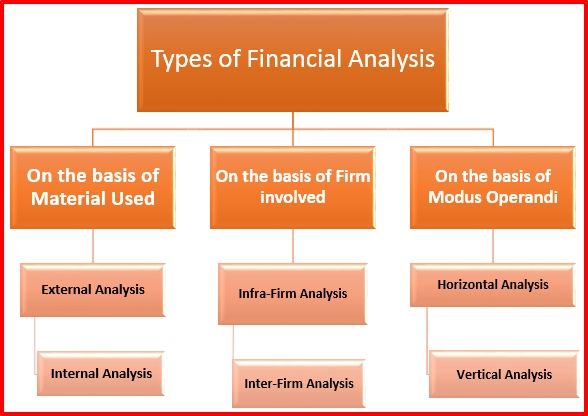
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| **S.No.** | **Cost Accounting** | **Management Accounting** |
| 1 | The main objective of cost accounting is to assist the management in cost control and decision-making. | The primary objective of management accounting is to provide necessary information to the management in the process of its planning, controlling, and performance evaluation, and decision-making. |
| 2 | Cost accounting system uses quantitative cost data that can be measured in monitory terms. | Management accounting uses both quantitative and qualitative data. It also uses those data that cannot be measured in terms of money. |
| 3 | Determination of cost and cost control are the primary roles of cost accounting. | Efficient and effective performance of a concern is the primary role of management accounting. |
| 4 | Success of cost accounting does not depend upon management accounting system. | Success of management accounting depends on sound financial accounting system and cost accounting systems of a concern. |
| 5 | Cost-related data as obtained from financial accounting is the base of cost accounting. | Management accounting is based on the data as received from financial accounting and cost accounting. |
| 6 | Provides future cost-related decisions based on the historical cost information. | Provides historical and predictive information for future decision-making. |
| 7 | Cost accounting reports are useful to the management as well as the shareholders and creditors of a concern. | Management accounting prepares reports exclusively meant for the management. |
| 8 | Only cost accounting principles are used in it. | Principals of cost accounting and financial accounting are used in management accounting. |
| 9 | Statutory audit of cost accounting reports are necessary in some cases, especially big business houses. | No statutory requirement of audit for reports. |
| 10 | Cost accounting is restricted to cost-related data. | Management accounting uses financial accounting data as well as cost accounting data. |

CHAPTER 2

**Analysis and Interpretation of Financial Statements**

Analysis and interpretation of financial statements are an attempt to determine the significance and meaning of the financial statement data so that a forecast may be made of the prospects for future earnings, ability to pay interest, debt maturities, both current as well as long term, and profitability of sound dividend policy.

The main function of financial analysis is the pinpointing of the strength and weaknesses of a business undertaking by regrouping and analysis of figures contained in financial statements, by making comparisons of various components and by examining their content. The analysis and interpretation of financial statements represent the last of the four major steps of accounting.





1. Comparative Statement or Comparative Financial and Operating Statements.
2. Common Size Statements.
3. Trend Ratios or Trend Analysis.
4. Average Analysis.
5. Statement of Changes in Working Capital.
6. Fund Flow Analysis.
7. Cash Flow Analysis.
8. Ratio Analysis.
9. Cost Volume Profit Analysis

A brief explanation of the tools or techniques of financial statement analysis presented below.

**1. Comparative Statements**

Comparative statements deal with the comparison of different items of the Profit and Loss Account and Balance Sheets of two or more periods. Separate comparative statements are prepared for Profit and Loss Account as Comparative Income Statement and for Balance Sheets.

As a rule, any financial statement can be presented in the form of comparative statement such as comparative balance sheet, comparative profit and loss account, comparative cost of production statement, comparative statement of working capital and the like.

**2. Comparative Income Statement**

Three important information are obtained from the Comparative Income Statement. They are Gross Profit, Operating Profit and Net Profit. The changes or the improvement in the profitability of the business concern is find out over a period of time. If the changes or improvement is not satisfactory, the management can find out the reasons for it and some corrective action can be taken.

**3. Comparative Balance Sheet**

The financial condition of the business concern can be find out by preparing comparative balance sheet. The various items of Balance sheet for two different periods are used. The assets are classified as current assets and fixed assets for comparison. Likewise, the liabilities are classified as current liabilities, long term liabilities and shareholders’ net worth. The term shareholders’ net worth includes Equity Share Capital, Preference Share Capital, Reserves and Surplus and the like.

**4. Common Size Statements**

A vertical presentation of financial information is followed for preparing common-size statements. Besides, the rupee value of financial statement contents are not taken into consideration. But, only percentage is considered for preparing common size statement.

The total assets or total liabilities or sales is taken as 100 and the balance items are compared to the total assets, total liabilities or sales in terms of percentage. Thus, a common size statement shows the relation of each component to the whole. Separate common size statement is prepared for profit and loss account as Common Size Income Statement and for balance sheet as Common Size Balance Sheet.

**5. Trend Analysis**

The ratios of different items for various periods are find out and then compared under this analysis. The analysis of the ratios over a period of years gives an idea of whether the business concern is trending upward or downward. This analysis is otherwise called as ***Pyramid Method***.

**6. Average Analysis**

Whenever, the trend ratios are calculated for a business concern, such ratios are compared with industry average. These both trends can be presented on the graph paper also in the shape of curves. This presentation of facts in the shape of pictures makes the analysis and comparison more comprehensive and impressive.

**7. Statement of Changes in Working Capital**

The extent of increase or decrease of working capital is identified by preparing the statement of changes in working capital. The amount of net working capital is calculated by subtracting the sum of current liabilities from the sum of current assets. It does not detail the reasons for changes in working capital.

**8. Fund Flow Analysis**

Fund flow analysis deals with detailed sources and application of funds of the business concern for a specific period. It indicates where funds come from and how they are used during the period under review. It highlights the changes in the financial structure of the company.

**9. Cash Flow Analysis**

Cash flow analysis is based on the movement of cash and bank balances. In other words, the movement of cash instead of movement of working capital would be considered in the cash flow analysis. There are two types of cash flows. They are actual cash flows and notional cash flows.

**10. Ratio Analysis**

Ratio analysis is an attempt of developing meaningful relationship between individual items (or group of items) in the balance sheet or profit and loss account. Ratio analysis is not only useful to internal parties of business concern but also useful to external parties. Ratio analysis highlights the liquidity, solvency, profitability and capital gearing.

**11. Cost Volume Profit Analysis**

This analysis discloses the prevailing relationship among sales, cost and profit. The cost is divided into two. They are fixed cost and variable cost. There is a constant relationship between sales and variable cost. Cost analysis enables the management for better profit planning.

CHAPTER 3

RATIO ANALYSIS

Ratio is an expression of relationship between two or more items in mathematical terms. Exhibition of meaningful and useful relation between different accounting data is called Accounting Ratio. Ratio may be expressed as a:b (a is to b), in terms of simple fraction, integer, or percentage.

If the current assets of a concern is Rs 4,00,000 and the current liabilities is Rs 2,00,000, then the ratio of current assets to current liabilities is given as 4,00,000 / 2,00,000 = 2. This is called simple ratio. Multiply a ratio by 100 to express it in terms of percentage.

We can express the ratio between 200 and 100 in any of the following ways:

* 2 : 1
* 2/1
* 200%
* 2 to 1
* 2

Ratios are extremely useful in drawing the financial position of a concern.

Accounting Analysis

Comparative analysis and interpretation of accounting data is called Accounting Analysis. When accounting data is expressed in relation to some other data, it conveys some significant information to the users of data.

Ratio Analysis and its Applications

Ratio analysis is a medium to understand the financial weakness and soundness of an organization. Keeping in mind the objective of analysis, the analyst has to select appropriate data to calculate appropriate ratios. Interpretation depends upon the caliber of the analyst.

Ratio analysis is useful in many ways to different concerned parties according to their respective requirements. Ratio analysis can be used in the following ways:

* To know the financial strength and weakness of an organization.
* To measure operative efficiency of a concern.
* For the management to review past year’s activity.
* To assess level of efficiency.
* To predict the future plans of a business.
* To optimize capital structure.
* In inter and intra company comparisons.
* To measure liquidity, solvency, profitability and managerial efficiency of a concern.
* In proper utilization of assets of a company.
* In budget preparation.
* In assessing solvency of a firm, bankruptcy position of a firm, and chances of corporate sickness.

Advantages of Ratio Analysis

* It is powerful tool to measure short and long-term solvency of a company.
* It is a tool to measure profitability and managerial efficiency of a company.
* It is an important tool to measure operating activities of a business.
* It helps in analyzing the capital structure of a company.
* Large quantitative data may be summarized using ratio analysis.
* It relates past accounting performances with the current.
* It is useful in coordinating the different functional machineries of a company.
* It helps the management in future decision-making.
* It helps in maintaining a reasonable balance between sales and purchase and estimating working capital requirements.

Limitations of Ratio Analysis

Although Ratio Analysis is a very useful accounting tools to analyze and interpret different accounting equations, it comes with its own set of limitations:

* If the data received from financial accounting is incorrect, then the information derived from ratio analysis could not be reliable.
* Unauthenticated data may lead to misinterpretation of ratio analysis.
* Future prediction may not be always dependable, as ratio analysis is based on the past performance.
* To get a conclusive idea about the business, a series of ratios is to be calculated. A single ratio cannot serve the purpose.
* It is not necessary that a ratio can give the real present situation of a business, as the result is based on historical data.
* Trend analysis is done with the help of various calculated ratios that can be distorted due to the changes in the price level.
* Ratio analysis is effective only where same accounting principles and policies are adopted by other concerns too, otherwise inter-company comparison will not exhibit a real picture at all.
* Through ratio analysis, special events cannot be identified. For example, maturity of debentures cannot be identified with ratio analysis.
* For effective ratio analysis, practical experience and knowledge about particular industry is essential. Otherwise, it may prove worthless.
* Ratio analysis is a useful tool only in the hands of an expert.

Types of Ratio

Ratios can be classified on the basis of financial statements or on the basis of functional aspects.

1. Classification on the Basis of Financial Statement

Balance Sheet Ratios

Ratios calculated from taking various data from the balance sheet are called balance sheet ratio. For example, current ratio, liquid ratio, capital gearing ratio, debt equity ratio, and proprietary ratio, etc.

Revenue Statement Ratio

Ratios calculated on the basis of data appearing in the trading account or the profit and loss account are called revenue statement ratios. For example, operating ratio, net profit ratio, gross profit ratio, stock turnover ratio.

Mixed or Composite Ratio

When the data from both balance sheet and revenue statements are used, it is called mixed or composite ratio. For example, working capital turnover ratio, inventory turnover ratio, accounts payable turnover ratio, fixed assets turnover ratio, return of net worth ratio, return on investment ratio.

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| **Classification of Ratios on the Basis of Financial Statements** | | |
| **Balance Sheet Ratios** | **Profit and Loss A/c Ratios** | **Composite or Mixed Ratios** |
| * Current Ratio * Liquid Ratio * Absolute Liquid Ratio * Debt Equity Ratio * Proprietorship Ratio * Capita Gearing Ratio * Assets Proprietorship Ratio * Capital Inventory to Working Capital Ratio * Ratio of Current Assets to Fixed Assets | * Gross Profit Ratio * Operating Ratio * Operating Profit Ratio * Net Profit Ratio * Cash Profit Ratio * Expenses Ratio * Interest Coverage Ratio | * Stock Turnover Ratio * Receivable Turnover Ratio * Payable Turnover Ratio * Fixed Assets Turnover Ratio * Total Assets Turnover Ratio * Working Capital Turnover Ratio * Capital Turnover Ratio * Return on Capital Employed * Return on Equity Ratio * Return on Shareholders Fund * Capital Turnover Ratio |

1. Classification on the Basis of Financial Aspects

Ratios can be further classified based on their functional aspects as discussed below.

Liquidity Ratios

Liquidity ratios are used to find out the short-term paying capacity of a firm, to comment short term solvency of the firm, or to meet its current liabilities. Similarly, turnover ratios are calculated to know the efficiency of liquid resources of the firm, Accounts Receivable (Debtors) Turnover Ratio and Accounts Payable (Creditors).

Long-Term Solvency and Leverage Ratios

Debt equity ratio and interest coverage ratio are calculated to know the efficiency of a firm to pay long-term debts and to meet interest costs. Leverage ratios are calculated to know the proportion of debt and equity in the financing of a firm.

Activity Ratios

Activity ratios are also called turnover ratios. Activity ratios measure the efficiency with which the resources of a firm are employed.

Profitability Ratios

The results of business operations can be calculated through profitability ratios. These ratios can also be used to know the overall performance and effectiveness of a firm. Two types of profitability ratios are calculated in relation to sales and investments.

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| **FUNCTIONAL CLASSIFICATION OF RATIOS** | | | |
| **Liquidity Ratios** | **Long-Term Solvency and Leverage Ratios** | **Activity Ratios Asset Management Ratios** | **Profit Abilities Ratios** |
| (A)   * Current Ratio * Liquid Ratio * Absolute Liquid or Cash Ratios * Interval Measure   (B)   * Debtors Turnover Ratio * Creditor Turnover Ratio * Inventory Turnover Ratio | * Debt/Equity Ratio * Debt to total Capital Ratio * Interest Coverage Ratio * Cash Flow/ Debt * Capital Gearing | * Inventory Turnover Ratio * Debtors Turnover Ratio * Fixed Assets Turnover Ratio * Total Assets Turnover Ratio * Working Capital Turnover Ratio * Payable Turnover Ratio * Capital Employed Turnover Ratio | **(A) In relation to sales**   * Gross Profit Ratio * Operating Ratio * Operating Ratio * Operative Profit Ratio * Net Profit Ratio * Expenses Ratio   **(B) In relation to Investments**   * Return on Investment * Return on Capital * Return on Equity * Return on Total * Resources * Earnings per Share * Price Earnings Ratio |

USEFUL RATIOS

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| --- | --- |
| **Short–term Financial Position or Test of Liquidity** | |
| (a) Current Ratios | =    Current Assets/ Current Liabilities |
| (b) Quick or Acid Test or Liquid Ratio | =  Liquid Assets / Current Liabilities |
| (c) Absolute Liquid Ratio | =  Absolute Liquid Assets/ Current Liabilities |
| (d) Interval Measure | =  Liquid Assets/ Avg.Daily Operating Expenses |
| **Current Assets Movement (Asset Management Ratios)** | |
| (a) Inventory /Stock Turnover Ratio | =  Cost of Goods Sold / Avg.Inventory at Cost |
| (b) Debtors or receivables Turnover Ratio/Velocity | =  Net Credit Annual Sale /Avg.Trade Debtors |
| (c) Average Collection Period | =  Total Trade Debtors/Sale per Day |
| (d) Creditors / Payable Turnover Ratio / Velocity | =  Net Credit Annual Purchase/Avg.Trade Creditors |
| (e) Average Payment Period | =  Total Trade Creditos Payable/Avg.Daily Purchase |
| (f) Working Capital Turnover Ratio | =  Sales or Cost of Sales/Net Working Capital |
| **Analysis of Long-term Financial Position or Test of Solvency** | |
| (a) Debt Equity Ratio | = Outsiders Funds/Shareholders′ Funds  or  =Outsiders′ Equities/Internal Equities |
| (b) Funded Debt to Total Capitalization Ratio | = Funded Debts/Total Capitalization× 100 |
| (c) Ratio of Long term Debt to Shareholders, Funds (Debt Equity) | = Long term Debts/Shareholders′ Funds |
| (d) Proprietary or Equity Ratio | = Shareholders Funds/Total Assets |
| (e) Solvency Ratio | = Total Liabilities to Outsiders/Total Assets |
| (f) Fixed Assets Net Worth Ratio | = Fixed Assets after Depreciation/Shareholders′ Funds |
| (g) Fixed Assets Ratio or Fixed Assets to Long Term Funds | = Fixed Assets after Depreciation/Total long term Fund |
| (h) Ratio of Current Assets to Proprietary funds | = Current Assets/Shareholders′ Funds |
| (i) Debt-Service or Interest Coverage | = Net Profit (before Int. & Taxes)/Fixed Interest Charges |
| (j) Total Coverage or Fixed Charge Coverage | = EBIT/Total Fixed Charges |
| (k) Preference Dividend Coverage Ratio | = Net Profit (before Int.& Tax)/Preference Dividend |
| (l) Cash to debt-Service Ratio or Debt Cash Flow Coverage | = CF  1 +  **SFD1 − Tax Rate**  CF = Annual cash flow before Int. & Tax  SFD = Sinking fund appropriation on debt |
| **Analysis of Profitability** | |
| (i) General Profitability: |  |
| (a) Gross Profit Ratio | =  Gross Profit/Net Sale× 100 |
| (b) Operating Ratio | =  Operating Cost/Net Sale× 100 |
| (c) Expenses Ratio | =  Particular Expense/Net Sale × 100 |
| (d) Net Profit Ratio | =  Net Profit after Tax/Net Sale× 100 |
| (e) Operating Profit Ratio | =  Operating Profit/Net Sale× 100 |
| **Overall Profitability** | |
| (a) Return on Shareholders’ Investment (RoI) | =  Net Profiti after Tax & Interest/Shareholders′ Fund× 100 |
| (b) Return on Equity Capital | =  Net Profit after Tax − Pref.Dividend/Paid up Equity Capital ×100 |
| (c) Earnings per Share (EPS) | = Net Profit after Tax − Pref.Dividend/Number of Equity Share  × 100 |
| (d) Return on Gross Capital Employed | = Adjusted Net Profit/Gross Capital Employed× 100 |
| (e) Return on Net Capital Employed | = Adjusted Net Profit/ Net Capital Employed× 100 |
| (f) Return on Assets | = Net Profit after Tax/Avg.Total Assets× 100 |
| (g) Capital Turnover Ratio | = Sale or Cost of Sale/Capital Employed× 100 |
| (h) Fixed Assets Turnover Ratio | = Sale or Cost of Goods SoldFixed Assets× 100 |
| (i) Working Capital Turnover Ratio | = Sale or Cost of Goods SoldNet Working Capital× 100 |
| **Market Test or Valuation Ratio** | |
| (a) Dividend Yield Ratio | = Dividend per Share/Market Value per Share |
| (b) Dividend Payout Ratio | = Dividend per Equity Share/Earnings per Share |
| (c) Price/Earnings (P/E) Ratio | = Market Price per Equity Share/Earnings per Share |
| (d) Earning Yield Ratio | = Earnings per Share/Market price per share |
| (e) Market Value Book Value Ratio | = Market value per share/Book value per share |
| (f) Market Price to Cash Flow Ratio | = Market price per share/Cash flow per share |
| **Market Test or Valuation Ratio** | |
| (a) Capital Gearing Ratio | = Equity Share Capital + Reserve & Surplus/Pref.Capital + Long term Debt bearing Fixed Interest |
| (b) Total Investment to Long Term Liabilities | = Shareholders Fund + Long term Liabilities/Long term Liabilities |
| (c) Debt Equity Ratio | = Outsiders Funds/Shareholders Funds |
| (d) Ratio to Fixed Assets to Funded Debt | = Fixed Assets/Funded Debts |
| (e) Ratio of Current Liabilities to Proprietors fund | = Current Liabilities/Shareholders′ Funds |
| (f) Ratio of Reserve to Equity Capital | = Reserves/Equity Share Capital× 100 |
| (g) Financial Leverage | = EBIT/EBIT − Interest & Pref.Dividend |
| (h) Operating Leverage | = Contribution/EBIT |