Notes by-

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Assignment NO. 3.

Q. 1. What do you mean by accouting & explain methods of accounting.

An account system involves a no. of books or record keeping. The daily transaction of the firm are represented in the books. The resources can be obtained either through cash or a bill purchase. Purchase creates an inventory that are used for the work execution. Bill purchase follows bill recipts that can be paid after verification from the site work execution follows payments receivable from the client.

The entire system starts with vouchers when cash flows out of the firm, the account is debited by debit vouchers. When cash flows into the firm, the account is created. The heart of the system are the account books where records by the vouchers are tabulated in a logical manner. In most cases at least four account book namely, the journal bank book, partly ledger & cash bank are maintained.

The following methods are adopted.

1) Straight line method.
2) Sum of year method.
3) Declining Balance method.

1) Straight line method:-

The name of the method is desired from the fact that is the end of the years assets accounts are plotted the result is a straight line with a slope equal to the annual depreciation rate. The formula for straight line depreciation is represented as,

$$= \frac{\text{Cost} - \text{Estimated value} + \text{Estimated maintenance}}{\text{Estimated life in years.}}$$

For eg:

If the cost is Rs 10,000/- the estimated value is Rs 1,000/- The estimated total repair value is Rs 2,000/- & estimated life is 5 years, the annual depreciation cost is Rs 2,200/- The net asset value at the end of the year is presented below.

Year	Depreciation	Repair Expenditure	Net asset at Year end (Rs)
1	2,200	100	7,900
2	2,200	200	5,900
3	2,200	300	4,000
4	2,200	400	2,800
5	2,200	500	1,000

2) Sum of years method :-

This is an accelerated depreciation method, the formula is,

$$D_t = \frac{n + 1 - t\,(c-s)}{\sum_{i}^{n} j}$$

Where, D_t = Depreciation in time t

c = Cost of assets

s = Estimated salvase of assets

n = Estimated life of assets in year.

t = Year of life of asset

$\sum_{i}^{n} j$ = Sum of digits from 1 to n.

A fixed rate is applied each year to the balance, the method result in decreasing the annual charges for depreciation. The following eg. one may use the following formula for the determination of the year.

$$\text{Depreciation rate} = 1 - n\sqrt{\frac{\text{Salvage value}}{\text{cost}}}$$

Year	Depreciation	Balance sheet
1	888.72	1411.28
2	545.31	865.96
3	334.66	531.35
4	208.31	326.03
5	125.97	200.00

Q/2] Discuss in detail, the different methods of obtaining finance for construction project.

The various sources of finance available can be broadly divided in to two catagories:

1) Equity Capital
2) Dept Capital.

Capital:

The enforces upon the organisation an obligation for repayment of principle & payment of interest. 1)

Equity Capital:

It serves as a cushion at times when the business conditions have unfavourable. Leading to operational difficulties. Interest paid 2)

Interest paid on debt capital is a deductible items of expenditure from the profit earned by the organisation on its earnings.

The following are the main sources of project finance.

1) Ordinary share
2) Preference share
3) Debentures
4) Bonds
5) Deferred credits
6) Term loans
7) Capital investment subsidary
8) Loose financing
9) Unsecured loans
10) ~~Interest on~~ Internal accucables
11) Bridge loans
12) Public deposits

1) Ordinary shares:

Ordinary shares are the source of permanent capital. The holders of ordinary shares are the legal owners of the company.

2) Preference shares:

Preference shares bears a predetermine rate of divided. They have prioprity of claim

over equity shares in the matter of dividants on non-cumulative preference shares do not add up for future payment.

Preference shares are two types:

1) Redeemable preference shares.
2) Irredemable preference shares.

3) Debentures:-

Debentures are instruments for raising long term debt capital. Debentures are secured by a charge on the present & future, immovable propertion of the company convertiable debentures are those debentures that are conventible in to equity shares at the option of the debenture holders.

4) Bonds:-

A bond is more or less simillar to a debenture & these two terms of frequenty used interchangeable.

5) Term loans:

The term "Term loan" long term loans offered for project financing. Term loans offered by all India financial institutions state financial corporations, state industrial

& investment cor. & commercial banks.

6) Defererred credits:-

Some machinary suppliers provide the facility of deferred credit provided the credit takes offers a bank guarentee. Banks obtain mortage of additional securities from credit takes to ensure that the bank does not stand to loose in the event of the gurantee being in worked by the machinary supplier due to non-repayment of defer installments.

7) Capital investment subsidy:

Govt. provides subsidy for the setting up of industries. The subsidy offered in two types.

a) Area subsidy

b) Product subsidy

8) Lease financing:-

Lease is a contract where by the lesser gives to the lesser the right to use the asset usually for an agreed period of periodical payment by the lease to the lesser called lease rental.

Lease as a source of project finance is mainly suitable for eg. projects.

9) Unsecured loans:

Bank & financial institutions view unsecured loans with an eye of caution they normally stipulate the following condition if unsecured loans is to be form part of means of finance.

10) Internal accounts:

Internal accounts from part of the means of finance in respect of expansion projects. An existing company that goes for an expansion project may opt to finance a portion of the capital investment out of internal cash accounts.

11) Bridge finance:

This is a temporary loan means for ticing up the capital cost of the project Bridge loans are sanctioned by banks & financial institutions in order to ~~kee~~ help speedly implementation of the project.

12) Public deposit:-

Public deposit are mobilised from the public in general & also from the share holders the interest rate on public deposits develops on the period on deposits.

5] What are the sources of working capital? What are the uses of working capital?

Sources of working capital:-

The typical sources of working capital are summerised as below:-

1) Funds from operations (adjusted net income)
2) Sale of non-current assets:
   - Sales of long term investment (shares, bonds, debentures etc.)
   - Sales of tangible fixed assets like land, building, plant or equipments.
   - Sales of intangible fixed assets like goodwill, patents or copyrights.
3) Long term financing.
   - long term borrowings (institutional loans, debentures, bonds etc.)
   - Inssuance of equity & preference shares.
4) Short term financing such as bank brorrowings.

Uses of working capital:-

The typical uses of working capital are as follows:-

1) Adjusted net loss from operations.
2) Purchase of non current assets.
3) • Purchase of long term investment like shares, bonds/ debentures etc.

- Purchase of tangible fixed assets, like land, building, plant, machinary, equipments etc.
- Purchase of intangible fixed assets, like good-will, patents, copyrights etc.

3) Repayment of long term debt (debentures or bonds) & short term beb debt (bank borrowing.)

4) Redemption of redeemable perference shares.

5) Payment of cash dividend.

Q.4] What do you mean by flow of funds? Explain methods of fund generation.

The statement of financial position charges which are prepared to determine only the sources & uses of working capital between dates of two balance sheets is known as fund flow statement, working capital determines the liquidity position of the firm.

As a historical analysis the statement of changes in working capital resuses to management in which working capital was obtained, reuses used with this insight, mgt. can prepare the estimates of the working capital flows. A statement reporting the change in working capital in addition to the financial statement. A projected statement of changes in working capital is immensly useful in the

firm range planning, mgt. for eg. wants to anticipate the working capital flows in order to plan the repayment schedules of its ~~wee~~ long term debt. for a fast growth & ~~examination~~ expansion of a firm needs larger amounts of working capital on along form basis are new also required to determine, wheather or not adequate working capital will be generate to meet the firms expansion. If not the firms can make arrangement is advance to produre fund from outside to meet its need.

Working Capital Flow:-

The working capital flow of fund arises when the net effect of a transation is to increase or decrease the amount of working capital. Normally a firm will have some transation that will change not working capital & some that will cause no change in not working capital.

Transactions which change net working capital include most of the items of the project & loss account & these business events which simultaneously affect both current & not-current balance sheet items. In profit & loss account the ~~reverse~~ revenue items because cash or

With cost of capital at 9% which proposal should be adopted?

Soln: Project A:-

Investment on project A = Rs 10,50,000
Life of project = 60 Years
Cost of capital = 9%

$$\frac{P}{A} = \frac{(1+i)^n - 1}{(1+i)^n \cdot i}$$

$$NPV(A) = 10,50,000 + 8,000 \left[\frac{(1+0.09)^{60} - 1}{(1+0.09)^{60} \times 0.09}\right]$$

$$= 1.13 \times 10^6 /-$$

Project B:-

Investment on project B = Rs 8,00,000/-
Life of project = 50 Years
Cost of capital = 9%

$$NPV(B) = 800,000 + 11,500 \left[\frac{(1+0.09)^{50} - 1}{(1+0.09)^{50} \times 0.09}\right]$$

$$= 920 \times 10^3 /-$$

$NPV(A) > NPV(B)$

∴ Project A is more feasible.

Q.7. Explain the basic ~~principles~~ concepts on which accounting systems are based.

The principles of accounting are built on a foundation of a few basic concept.

1) Money measurement:

The ~~basic~~ concept imposses a limitations on the scope an accounting report. A number of important information may strain outside the accounting report because of this limitation.

2) Business entity:-

Accounting are kept for business entity as distinguished from the persons who are associated with less these entities. In accounting, each account is treated as an entity irrespective of its ownership the entity concept has significant effect on the taxation of a firm.

3) Goving convern:-

In accounting, a business is viewed as a mechanism for creating value for perpelcuity resources owned by the firm is shown assists purchase price less accumulated depreciation. The current resale value is since it is assumed that there will not be cord as such

rather these would be used in the creation of future output value.

4) Cost reporting :-

The resources like securities land building, plant & equipments that a business owns are called as sets worth of an asset any change with time for a variety of reasons The books value & the market value of an asset may be quite different. The cost concept is used for objective.

5) ~~Double entry systems~~ :- Time of realisation.

A firm generally providing services of earn revenue continuously. The cheque recieved in one accounting period may vary will be for the service standard in a privious accounting period. The concept has an important bearing upon cashflow & transaction.

7) Double entry system :

This system is true for most of the account Every event that is rewarded in the accounts affects at least two items one each from the asset & ~~liqui~~ liability side.

Assets = Liability + Owners equity.

Dual entry system, which has both conceptional & arithmatical advantages is universally accepted.

7) Matening concept :-

This concept guides that to the extent feasible the costs are reported as express in the period in which the recipts are taken as only advance recieved.

8) Consistancy concept :-

This concept requires that over a firm has decided on one method it wants all subsequent events by the same method. If diff. methods are used for the same class of event, accounting information can not be confidently corpaired.

9) Materiality concept :-

The account does not attempt to record events to such detail that the record keeping itself becomes unjustified by the usefulness of the results.

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