SRINIVASAN ENGINEERING COLLEGE

BA9206 – ACCOUNTING FOR MANAGEMENT

DEPARTMENT OF MBA

QUESTION BANK

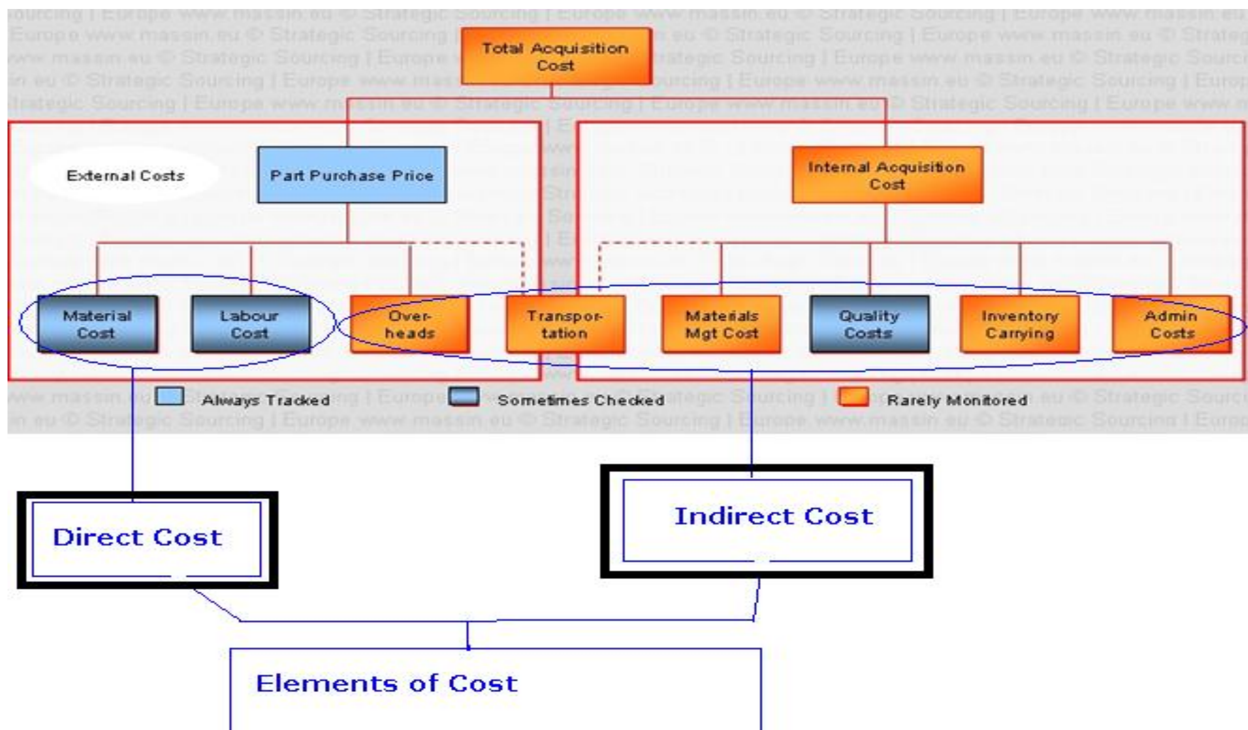
SEM/YEAR: I/I

1. **Accounting** is defined "the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of financial character, and interpreting the results thereof."
2. **Funds flow Statement**

Fund flow statement shows the inflow and outflow of fund of an organization, it provide complete information about the fund investment.

Fund flow statement explain the how much fund go outside and inside, in this way it help to know the financial position of the organization if inflow is more than outflow it means company is financially strong.

3. **Elements of cost**



4. **Break even point**

   Point at which Total cost is equals to Total Revenue (TR =TC)

   No profit and no loss point

   Where total cost = Total Fixed cost and Total Variable cost i.e., cost of making a product

   Total revenue is Realised by making sale of the product produced

BEP is a level at which neither profit nor loss situation.

5. **Zero Based Budgeting:**

A method of budgeting in which all expenses must be justified for each new period. Zero-based budgeting starts from a "zero base" and every function within an organization is analyzed for its needs and costs. Budgets are then built around what is needed for the upcoming period, regardless of whether the budget is higher or lower than the previous one.

ZBB allows top-level strategic goals to be implemented into the budgeting process by tying them to specific functional areas of the organization, where costs can be first grouped, then measured against previous results and current expectations.

6. **Master Budget**

Set of operating budgets related to finance, operations, production, sales, etc., and including projected (pro forma) cashflow statement, income statement, and balance sheet.

7. Goals of Financial management

Maximisation Gosl	**Minimisation Goal**
Profit **Profitablility** **Liquidity** **Solvency** **Earnings Per Share**	**Cost** **Risk**
Clubing both Maximise Wealth and Economic Value Addition	

8. Weighted Average Cost of Capital

The **weighted average cost of capital (WACC)** is the rate that a company is expected to pay on average to all its security holders to finance its assets.

The WACC is the minimum return that a company must earn on an existing asset base to satisfy its creditors, owners, and other providers of capital, or they will invest elsewhere. Companies raise money from a number of sources: common equity, preferred equity, straight debt, convertible debt, exchangeable debt, warrants, options, pension liabilities, executive stock options, governmental subsidies, and so on. Different securities are expected to generate different returns. The WACC is calculated taking into account the relative weights of each component of the capital structure and is used to see if the investment is worthwhile to undertake.

9. Optimum Capital Structure

Capital Structure: A company's ratio of long-term debt to equity.

Optimal Capital Structure: A "best" debt/equity ratio for a company. This is the debt/equity ratio that will minimize the cost of capital, i.e., the cost of financing the company's operations.

10. Concepts of working capital

There are two definitions of working capital (1) Gross working capital (2) Net working capital

Gross working capital refers to working capital as the total of current assets, whereas the net working capital refers to working capital as excess of current assets over current liabilities. In other words net working capital refers to current assets financed by long term funds.

Accordingly,

Gross working capital = Total current assets
Net working capital = Current assets – Current liabilities

11.a. Accounting Ratios/Uses and Limitations

Definition of Accounting Ratios:

The term "**accounting ratios**" is used to describe significant relationship between figures shown on a balance sheet, in a profit and loss account, in a budgetary control system or in any other part of accounting organization. **Accounting ratios** thus shows the relationship between accounting data.

Ratios can be found out by dividing one number by another number. Ratios show how one number is related to another. It may be expressed in the form of co-efficient, percentage, proportion, or rate. For example the current assets and current liabilities of a business on a particular date are $200,000 and $100,000 respectively. The ratio of current assets and current liabilities could be expressed as 2 (i.e. 200,000 / 100,000) or 200 percent or it can be expressed as 2:1 i.e., the current assets are two times the current liabilities. Ratio sometimes is expressed in the form of rate. For instance, the ratio between two numerical facts, usually over a period of time, e.g. stock turnover is three times a year.

12.Advantages of Ratios Analysis:

Ratio analysis is an important and age-old technique of financial analysis. The following are some of the advantages / Benefits of ratio analysis:

1. **Simplifies financial statements:** It simplifies the comprehension of financial statements. Ratios tell the whole story of changes in the financial condition of the business
2. **Facilitates inter-firm comparison:** It provides data for inter-firm comparison. Ratios highlight the factors associated with with successful and unsuccessful firm. They also reveal strong firms and weak firms, overvalued and undervalued firms.
3. **Helps in planning:** It helps in planning and forecasting. Ratios can assist management, in its basic functions of forecasting. Planning, co-ordination, control and communications.
4. **Makes inter-firm comparison possible:** Ratios analysis also makes possible comparison of the performance of different divisions of the firm. The ratios are helpful in deciding about their efficiency or otherwise in the past and likely performance in the future.
5. **Help in investment decisions:** It helps in investment decisions in the case of investors and lending decisions in the case of bankers etc.

13.Limitations of Ratios Analysis:

The ratios analysis is one of the most powerful tools of financial management. Though ratios are simple to calculate and easy to understand, they suffer from serious limitations.

1. **Limitations of financial statements:** Ratios are based only on the information which has been recorded in the financial statements. Financial statements themselves are subject to several limitations. Thus ratios derived, there from, are also subject to those limitations. For example, non-financial changes though important for the business are not relevant by the financial statements. Financial statements are affected to a very great extent by accounting conventions and concepts. Personal judgment plays a great part in determining the figures for financial statements.
2. **Comparative study required:** Ratios are useful in judging the efficiency of the business only when they are compared with past results of the business. However, such a comparison only provide glimpse of the past performance and forecasts for future may not prove correct since several other factors like market conditions, management policies, etc. may affect the future operations.
3. Ratios alone are not adequate: Ratios are only indicators, they cannot be taken as final regarding good or bad financial position of the business. Other things have also to be seen.
4. **Problems of price level changes:** A change in price level can affect the validity of ratios calculated for different time periods. In such a case the ratio analysis may not clearly indicate the trend in solvency and profitability of the company. The financial statements, therefore, be adjusted keeping in view the price level changes if a meaningful comparison is to be made through accounting ratios.

5. Lack of adequate standard: No fixed standard can be laid down for ideal ratios. There are no well accepted standards or rule of thumb for all ratios which can be accepted as norm. It renders interpretation of the ratios difficult.
6. **Limited use of single ratios:** A single ratio, usually, does not convey much of a sense. To make a better interpretation, a number of ratios have to be calculated which is likely to confuse the analyst than help him in making any good decision.
7. **Personal bias:** Ratios are only means of financial analysis and not an end in itself. Ratios have to interpreted and different people may interpret the same ratio in different way.
8. **Incomparable:** Not only industries differ in their nature, but also the firms of the similar business widely differ in their size and accounting procedures etc. It makes comparison of ratios difficult and misleading.

14.budgetary control

Definition

Methodical control of an organization's operations through establishment of standards and targets regarding income and expenditure, and a continuous monitoring and adjustment of performance against them.

Uses

Like other **control methods**, budgets have the potential to help organizations and their members reach their goals. **Budget control** offers several advantages to managers. Some of these are:

- The major strength of budgeting is that it coordinates activities across departments.
- Budgets translate **strategic plans** into action. They specify the resources, revenues, and activities required to carry out the strategic plan for the coming year.
- Budgets provide an excellent record of organizational **activities**.
- Budgets improve **communication** with employees.
- Budgets improve **resources allocation**, because all requests are clarified and justified.
- Budgets provide a tool for corrective action through **reallocations**.

15.a. Factors affect the capital structure

capital structure refers to the way a corporation finances its assets through some combination of equity, debt, or hybrid securities. A firm's capital structure is then the composition or 'structure' of its liabilities.

Capital Structure is referred to as the ratio of different kinds of securities raised by a firm as long-term finance. The capital structure involves two decisions-

a. Type of securities to be issued are equity shares, preference shares and long term borrowings(Debentures).

b. Relative ratio of securities can be determined by process of capital gearing. On this basis, the companies are divided into two-
    a. Highly geared companies- Those companies whose proportion of equity capitalization is small.
    b. Low geared companies- Those companies whose equity capital dominates total capitalization.

For instance - There are two companies A and B. Total capitalization amounts to be Rs. 20 lakh in each case. The ratio of equity capital to total capitalization in company A is Rs. 5 lakh, while in company B, ratio of equity capital is Rs. 15 lakh to total capitalization, i.e, in Company A, proportion is 25% and in company B, proportion is 75%. In such cases, company A is considered to be a highly geared company and company B is low geared company.

16.Trading on Equity- The word "equity" denotes the ownership of the company. Trading on equity means taking advantage of equity share capital to borrowed funds on reasonable basis. It refers to additional profits that equity shareholders earn because of issuance of debentures and preference shares. It is based on the thought that if the rate of dividend on preference capital and the rate of interest on borrowed capital is lower than the general rate of company's earnings, equity shareholders are at advantage which means a company should go for a judicious blend of preference shares, equity shares as well as debentures. Trading on equity becomes more important when expectations of shareholders are high.

17.Degree of control- In a company, it is the directors who are so called elected representatives of equity shareholders. These members have got maximum voting rights in a concern as compared to the preference shareholders and debenture holders. Preference shareholders have reasonably less voting rights while debenture holders have no voting rights. If the company's management policies are such that they want to retain their voting rights in their hands, the capital structure consists of debenture holders and loans rather than equity shares.

18.Flexibility of financial plan- In an enterprise, the capital structure should be such that there is both contractions as well as relaxation in plans. Debentures and loans can be refunded back as the time requires. While equity capital cannot be refunded at any point which provides rigidity to plans. Therefore, in order to make the capital structure possible, the company should go for issue of debentures and other loans.

19.Choice of investors- The company's policy generally is to have different categories of investors for securities. Therefore, a capital structure should give enough choice to all kind of investors to invest. Bold and adventurous investors generally go for equity shares and loans and debentures are generally raised keeping into mind conscious investors.

20.Capital market condition- In the lifetime of the company, the market price of the shares has got an important influence. During the depression period, the company's capital structure generally consists of debentures and loans. While in period of boons and inflation, the company's capital should consist of share capital generally equity shares.

21.Period of financing- When company wants to raise finance for short period, it goes for loans from banks and other institutions; while for long period it goes for issue of shares and debentures.

22.Cost of financing- In a capital structure, the company has to look to the factor of cost when securities are raised. It is seen that debentures at the time of profit earning of company prove to be a cheaper source of finance as compared to equity shares where equity shareholders demand an extra share in profits.

23.Stability of sales- An established business which has a growing market and high sales turnover, the company is in position to meet fixed commitments. Interest on debentures has to be paid regardless of profit. Therefore, when sales are high, thereby the profits are high and company is in better position to meet such fixed commitments like interest on debentures and dividends on preference shares. If company is having unstable sales, then the company is not in position to meet fixed obligations. So, equity capital proves to be safe in such cases.

24.Sizes of a company- Small size business firms capital structure generally consists of loans from banks and retained profits. While on the other hand, big companies having goodwill, stability and an established profit can easily go for issuance of shares and debentures as well as loans and borrowings from financial institutions. The bigger the size, the wider is total capitalization.

25.Accounting concepts

Business entity concept
Money measurement concept
Going concern concept
Accounting period concept
Accounting cost concept
Duality aspect concept
Realisation concept
Accrual concept
Matching concept

26.Accounting Conventions

Convention of consistency.
Convention of full disclosure.
Convention of materiality.
Convention of conservatism.

27.Books of accounmts: Journals, ledgers, and other classified records comprising a firm"s set of accounts

28.journal

Definition

Business diary in which all financial data (taken usually from a journal voucher) pertaining to the day to day business transactions of a firm is recorded using double-entry bookkeeping system. Debit and credit changes caused by each transaction in individual ledger-accounts are subsequently entered in (posted to) the firm's general ledger. Depending on the nature of its operations and number of daily transactions, a firm may keep several types of specialized journals such as cash journal (cash book), purchases journal, and sales journal. The most common is general journal, used where no special journal exists or in which transactions not belonging to other journals are entered (see journal entry). Journals are also called 'books of first entry' or 'books of original entry.'

29.Ledger

ledger, sometimes known as the **nominal** ledger, is the main accounting record of a business which uses double-entry bookkeeping. It will usually include accounts for such items as current assets, fixed assets, liabilities, revenue and expense items, gains and losses. Each General Ledger is divided into two sections. The left hand side lists debit transactions and the right hand side lists credit transactions. This gives a 'T' shape to each individual general ledger account.

A "T" account showing debits on the left and credits on the right.

Debits	Credits

The general ledger is a collection of the group of accounts that supports the value items shown in the major financial statements. It is built up by posting transactions recorded in the sales daybook, purchases daybook, cash book and general journals daybook. The general ledger can be supported by one or more subsidiary ledgers that provide details for accounts in the general ledger. For instance, an accounts receivable subsidiary ledger would contain a separate account for each credit customer, tracking that customer's balance separately. This subsidiary ledger would then be totalled and compared with its controlling account (in this case, Accounts Receivable) to ensure accuracy as part of the process of preparing a trial balance.[1]

There are seven basic categories in which all accounts are grouped:

1. Assets
2. Liability
3. Owner's equity
4. Revenue
5. Expense
6. Gains (Profits)
7. Losses

30.Trial Balance

A **trial balance** is a list of all the nominal ledger (general ledger) accounts contained in the ledger of a business. This list will contain the name of the nominal ledger account and the value of that nominal ledger account. The value of the nominal ledger will hold either a debit balance value or a credit value balance. The debit balance values will be listed in the debit column of the trial balance and the credit value balance will be listed in the credit column. The profit and loss statement and balance sheet and other financial reports can then be produced using the ledger accounts listed on the trial balance.

31.Final accounts

Definition

Accounts made up only at the end of a firm's financial year. For a manufacturing firm, the final accounts consist of (1) manufacturing account, (2) trading account, (3) profit and loss account, and (4) profit and loss appropriation account. A trading firm's final accounts will include all of the above except the manufacturing account. Together, these accounts generate the gross profit, net income, and distribution of net income figures of the firm.

32.Trading account

That part of an income statement which shows how the gross (operating) profit was generated through the firm's trading activities.

33.Profit and loss account

Alternative term for revenue account.

A profit and loss account is a financial statement that summarizes the financial transactions for a business over a period in time. In reference to charitable organisations it is sometimes known as an Income and Expenditure account.

34.Balance sheet

In financial accounting, a **balance sheet** or **statement of financial position** is a summary of the financial balances of a sole proprietorship, a business partnership or a company. Assets, liabilities and ownership equity are listed as of a specific date, such as the end of its financial year. A balance sheet is often described as a "snapshot of a company's financial condition".[1] Of the four basic financial statements, the balance sheet is the only statement which applies to a single point in time of a business' calendar year.

A standard company balance sheet has three parts: assets, liabilities and ownership equity. The main categories of assets are usually listed first, and typically in order of liquidity.[2] Assets are followed by the liabilities. The difference between the assets and the liabilities is known as equity or the net assets or the net worth or capital of the company and according to the accounting equation, net worth must equal assets minus liabilities.[3]

Another way to look at the same equation is that assets equals liabilities plus owner's equity. Looking at the equation in this way shows how assets were financed: either by borrowing money (liability) or by using the owner's money (owner's equity). Balance sheets are usually presented with assets in one section and liabilities and net worth in the other section with the two sections "balancing."

35.Accounts of non profit making organisations

A **non-profit organization** (abbreviated as **NPO**, also known as a **not-for-profit organization**[1]) is an organization that does not distribute its surplus funds to owners or shareholders, but instead uses them to help pursue its goals.[2] Examples of NPOs include charities (i.e. charitable organizations), trade unions, and public arts organizations. Most governments and government agencies meet this definition, but in most countries they are considered a separate type of organization and not counted as NPOs. They are in most countries exempt from income and property taxation.

36.Receipts and payments account

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It is an abridged edition of Cash Book-it is, in effect, a summary of Cash Book.
All cash receipts during the whole year are recorded on its left-hand side, while all cash payments during the whole year are written on its right-hand side, arranged in a classified form.Cash receipts and cash payments of both capital and revenue nature are recorded here.Only

cash transactions are recorded here.

It will generally show debit balance. In case of bank overdraft balance, however, its net balance may be credit. Again, it may also show nil balance-but such occasion is rare.
Its closing balance indicates closing cash in hand and closing cash at bank.
It is not an account within the Double Entry System-it is statement only.
It is prepared on the last day of the accounting year.

Advantages:
The receipts and total payments under various heads are available at a glance.
The amount of cash in hand at the year-end can be ascertained.
The correctness of Cash Book can be verified through it.
The total of Debit side of Cash Book will agree with that of Receipts side of Receipts and Payments Account. On the other hand, the total of Credit side of Cash Book will agree with that of payments side of Receipts and Payments Account.

37.Income and expenditure account

An income and expenditure account is an account, similar to a profit and loss account, prepared by an organization whose main purpose is not the generation of profit. It records the income and expenditure of the organization and results in either a surplus of income over expenditure or of expenditure over income.

38.Management accounting or **managerial accounting** is concerned with the provisions and use of accounting information to managers within organizations, to provide them with the basis to make informed business decisions that will allow them to be better equipped in their management and control functions.

In contrast to financial accountancy information, management accounting information is:

- designed and intended for use by managers within the organization, instead of being intended for use by shareholders, creditors, and public regulators;
- usually confidential and used by management, instead of publicly reported;
- forward-looking, instead of historical;
- computed by reference to the needs of managers, often using management information systems, instead of by reference to general financial accounting standards.

39.Users of accounting information

- Cost and management accounting – provision of information to managers to help them in decision-making, planning and control.
- Financial accounting – provision of information to external users outside the business.

40.Funds flow Statement

"A statement of Sources and Application of Funds is a technical device designed to analyse the changes in the financial condition of a business enterprises between two dates."

Funds Flow Statement is not an income statement . Income statement shows the items of income and expenditure of a particular period, but the Funds flow statement is an operating statement as it summaries the financial activities for a period of time. It covers all movements that involve an actual exchange of assets.

Various titles are used for this statement such as 'Statement of sources and Application of Funds', 'Summary of Financial operations,' 'Changes in Financial Position', 'Fund received and Disbursed', 'Funds Generated and Expended', Changes in Working Capital", "Statement of Fund' etc. Title of Funds Flow Statement has been modified from time to time. Really it is very difficult to find a short time for such statement which carries much to the readers regarding its contents an functions.

A new interpretation of the term 'funds, has now been adopted as to include assets or financial resourceful which do not flow through the working capital accounts. It seems to be the most suitable meaning fort the term 'funds' but the most commonly used interpretation of the term 'funds' is 'working capital'

41.Cash flow statement

cash flow statement, also known as statement of cash flows or funds flow statement,[1] is a financial statement that shows how changes in balance sheet accounts and income affect cash and cash equivalents, and breaks the analysis down to operating, investing, and financing activities. Essentially, the cash flow statement is concerned with the flow of cash in and cash out of the business. The statement captures both the current operating results and the accompanying changes in the balance sheet.[1] As an analytical tool, the statement of cash flows is useful in determining the short-term viability of a company, particularly its ability to pay bills. International Accounting Standard 7 (IAS 7), is the International Accounting Standard that deals with cash flow statements.

42.People and groups interested in cash flow statements include:

- Accounting personnel, who need to know whether the organization will be able to cover payroll and other immediate expenses
- Potential lenders or creditors, who want a clear picture of a company's ability to repay
- Potential investors, who need to judge whether the company is financially sound
- Potential employees or contractors, who need to know whether the company will be able to afford compensation
- Shareholders of the business.

43.**Financial statement analysis** is defined as the process of identifying financial strengths and weaknesses of the firm by properly establishing relationship between the items of the balance sheet and the profit and loss account.

There are various methods or techniques that are used in analyzing financial statements, such as comparative statements, schedule of changes in working capital, common size percentages, funds analysis, trend analysis, and ratios analysis.

Financial statements are prepared to meet external reporting obligations and also for decision making purposes. They play a dominant role in setting the framework of managerial decisions. But the information provided in the financial statements is not an end in itself as no meaningful conclusions can be drawn from these statements alone. However, the information provided in the financial statements is of immense use in making decisions through analysis and interpretation of financial statements.

44.Tools and Techniques of Financial Statement Analysis:

Following are the most important tools and techniques of financial statement analysis:

1. Horizontal and Vertical Analysis
2. Ratios Analysis

1. Horizontal and Vertical Analysis:

Horizontal Analysis or Trend Analysis**:**

Comparison of two or more year's financial data is known as **horizontal analysis**, or trend analysis. Horizontal analysis is facilitated by showing changes between years in both dollar and percentage form. Click here to read full article.

Trend Percentage**:**

Horizontal analysis of financial statements can also be carried out by computing **trend percentages**. Trend percentage states several years' financial data in terms of a base year. The base year equals 100%, with all other years stated in some percentage of this base. Click here to read full article.

Vertical Analysis**:**

Vertical analysis is the procedure of preparing and presenting common size statements. **Common size statement** is one that shows the items appearing on it in percentage form as well as in dollar form. Each item is stated as a percentage of some total of which that item is a part. Key financial changes and trends can be highlighted by the use of common size statements. Click here to read full article.

45. Ratios Analysis:

Accounting Ratios Definition, Advantages, Classification and Limitations**:**

The ratios analysis is the most powerful tool of financial statement analysis. Ratios simply means one number expressed in terms of another. A ratio is a statistical yardstick by means of which relationship between two or various figures can be compared or measured. Ratios can be found out by dividing one number by another number. Ratios show how one number is related to another. Click here to read full article.

46.Profitability Ratios:

Profitability ratios measure the results of business operations or overall performance and effectiveness of the firm. Some of the most popular profitability ratios are as under:

- Gross profit ratio
- Net profit ratio
- Operating ratio
- Expense ratio
- Return on shareholders investment or net worth
- Return on equity capital
- Return on capital employed (ROCE) Ratio
- Dividend yield ratio
- Dividend payout ratio
- Earnings Per Share Ratio
- Price earning ratio

47.Liquidity Ratios:

Liquidity ratios measure the short term solvency of financial position of a firm. These ratios are calculated to comment upon the short term paying capacity of a concern or the firm's ability to meet its current obligations. Following are the most important liquidity ratios.

- Current ratio
- Liquid / Acid test / Quick ratio

48.Activity Ratios:

Activity ratios are calculated to measure the efficiency with which the resources of a firm have been employed. These ratios are also called turnover ratios because they indicate the speed with which assets are being turned over into sales. Following are the most important activity ratios:

- Inventory / Stock turnover ratio
- Debtors / Receivables turnover ratio
- Average collection period
- Creditors / Payable turnover ratio

- Working capital turnover ratio
- Fixed assets turnover ratio
- Over and under trading

49.Long Term Solvency or Leverage Ratios:

Long term solvency or leverage ratios convey a firm's ability to meet the interest costs and payment schedules of its long term obligations. Following are some of the most important long term solvency or leverage ratios.

- Debt-to-equity ratio
- Proprietary or Equity ratio
- Ratio of fixed assets to shareholders funds
- Ratio of current assets to shareholders funds
- Interest coverage ratio
- Capital gearing ratio
- Over and under capitalization

50.Capital budgeting (or investment appraisal) is the planning process used to determine whether a firm's long term investments such as new machinery, replacement machinery, new plants, new products, and research development projects are worth pursuing. It is budget for major capital, or investment, expenditures.[1]

Many formal methods are used in capital budgeting, including the techniques such as

- Accounting rate of return
- Net present value
- Profitability index
- Internal rate of return
- Modified internal rate of return
- Equivalent annuity

These methods use the incremental cash flows from each potential investment, or project Techniques based on accounting earnings and accounting rules are sometimes used - though economists consider this to be improper - such as the accounting rate of return, and "return on investment." Simplified and hybrid methods are used as well, such as payback period and discounted payback period.

51.Standard Costing.

The CIMA, London has defined standard cost as “a predetermined cost which is calculated from managements standards of efficient operations and the relevant necessary expenditure.” They are the predetermined costs on technical estimate of material labor and overhead for a selected period of time and for a prescribed set of working conditions. In other words, a standard cost is a planned cost for a unit of product or service rendered.

The technique of using standard costs for the purposes of cost control is known as standard costing. It is a system of cost accounting which is designed to find out how much should be the cost of a product under the existing conditions. The actual cost can be ascertained only when production is undertaken. The predetermined cost is compared to the actual cost and a variance between the two enables the management to take necessary corrective measures.

52.Working capital (abbreviated **WC**) is a financial metric which represents operating liquidity available to a business, organization, or other entity, including governmental entity. Along with fixed assets such as plant and equipment, working capital is considered a part of operating capital. It is calculated as current assets minus current liabilities. If current assets are less than current liabilities, an entity has a **working capital deficiency**, also called a **working capital deficit**. Net working capital is working capital minus cash (which is a current asset) and minus interest bearing liabilities (i.e. short term debt). It is a derivation of working capital, that is commonly used in valuation techniques such as DCFs (Discounted cash flows).

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

A company can be endowed with assets and profitability but short of liquidity if its assets cannot readily be converted into cash. Positive working capital is required to ensure that a firm is able to continue its operations and that it has sufficient funds to satisfy both maturing short-term debt and upcoming operational expenses. The management of working capital involves managing inventories, accounts receivable and payable and cash.