

Introduction to Business Accounting

Chapter 13 - Fiscal Year

WORKBOOK

Fiscal Year

Fiscal Year is the time period over which the annual accounting cycle takes place. The period is adopted by a business for reporting purposes.

- The Fiscal Year often runs from January 1 to December 31, however, this is not required and will vary by country and industry.
- Many businesses choose to adopt a Fiscal Year that either reflects the start date of the business or reflects the point when business activities are at their lowest point. The latter is called the Natural Business year.
 - In retail this is February or March after the holiday season when their inventory is at a low point.
 - For Universities this is in the summer months when most students are on break.
- Other businesses align their Fiscal Year end with their countries tax year.

Additional Accounting Terms

- Liquidity is the ability to convert assets into cash. Next to cash the most liquid asset is accounts receivable and investments.
- Solvency is the ability of a business to pay debts. A business is insolvent if they are bankrupt and cannot pay their bills.
- Working Capital is the most liquid assets that a business uses to carry out it's normal operations. It is calculated as the excess of current assets over current liabilities
- Current Ratio is a measure used to evaluate the solvency of a business. It is computed by dividing current assets by current liabilities. The general rule is a 2 to 1 ratio.

Working Capital and Current Ratio

Based on our information on XYZ:

$$\begin{aligned}\text{Working Capital} &= \text{Current Assets} - \text{Current Liabilities} \\ &= \$56,775 - \$23,750 \\ &= \$33,025\end{aligned}$$

$$\begin{aligned}\text{Current Ratio} &= \text{Current Assets} / \text{Current Liabilities} \\ &= \$56,775 / \$23,750 \\ &= 2.4 \text{ (Rounded)}\end{aligned}$$



Questions

and

Answers

Review Questions:

1. True or False: Most companies that declare bankruptcy have current ratios of 3 or more.
 - A. True
 - B. False
2. True or False: The fiscal year end for all companies is December 31st regardless of industry or country.
 - A. True
 - B. False
3. What is liquidity?
 - A. The ability to convert assets into cash
 - B. The ability of a business to pay debts
 - C. A measure used to evaluate the solvency of a business
 - D. None of the above
4. True or False: Working Capital is calculated as the excess of current assets over current liabilities.
 - A. True
 - B. False
5. True or False: The current ratio is calculated as current assets divided by current liabilities.
 - A. True
 - B. False

Answer Key:

1. B
False. Most companies that declare bankruptcy have current ratios of less than 2.
2. B
False. The fiscal year end for all companies depends heavily on the industry or country.
3. A
Liquidity is the ability to convert assets into cash.
4. A
True. Working Capital is calculated as the excess of current assets over current liabilities.
5. A
True. The current ratio is calculated as current assets divided by current liabilities.