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Accounting Policies and its Financial Structure with Special Reference to Ashok Leyland Ltd, at Hosur.

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ABSTRACT

This study explores the intricate relationship between accounting policies and the financial structure of an organization. Accounting policies, which govern the methods and procedures used in financial reporting, play a pivotal role in shaping how financial information is recorded, interpreted, and disclosed. Their impact extends beyond compliance, influencing key financial indicators such as debt-equity ratio, liquidity, and profitability. This paper analyzes how variations in accounting methods such as revenue recognition, inventory valuation, and depreciation can alter financial statements and thus affect stakeholders' perception of a firm's financial health. The study investigates the strategic use of accounting policies to manage earnings and align with capital structure decisions.

Key words: debt-equity ratio, liquidity, and profitability, revenue recognition, inventory valuation, and depreciation

INTRODUCTION

Accounting policies refer to the specific principles, methods, and practices that a company adopts to prepare and present its financial statements. These policies are critical in ensuring consistency, transparency, and comparability in financial reporting, as they govern how a company recognizes, measures, and discloses its financial transactions. Common areas where accounting policies are applied include revenue recognition, asset valuation, depreciation methods, inventory valuation, and treatment of liabilities. The financial structure also influences strategic decisions, such as the ability to invest in new projects, pay dividends, or repurchase shares. The alignment between accounting policies and financial structure is essential for providing an accurate picture of a company's financial health. For example, decisions regarding asset valuation methods (such as fair value or historical cost) can significantly impact the company's reported net worth, influencing how stakeholders perceive its financial stability.

RESEARCH BACKGROUND

Ashok Leyland, founded in 1948 and headquartered in Chennai, India, is a leading commercial vehicle manufacturer and a flagship company of the Hinduja Group. It is the second-largest manufacturer of commercial vehicles in India, the fourth-largest bus manufacturer in the world, and among the top ten truck manufacturers globally. The company initially collaborated with British Leyland and has since grown to serve over 50 countries, offering a wide range of products including trucks, buses, defense vehicles, and power solutions. Known for innovation and robust engineering, Ashok Leyland plays a crucial role in India's transportation and logistics sector.

GLOBAL TRADE DYANAMICS AND EXPORT OPPORTUNITIES

Ashok Leyland is rapidly expanding its global presence, targeting 20% of its revenue from exports within five years. With strong growth in GCC, SAARC, and African markets, it has set up assembly units in the UAE, Nigeria, and South Africa. Plans are underway to enter ASEAN nations like Malaysia and the Philippines, along with a foray into Europe via electric buses in 2025. This export-focused strategy aligns with its ambition to rank among the world's top commercial vehicle manufacturers.

IDENTIFIED PROBLEM

Requires a deep understanding of global market economical dynamics and challenges. In diversification of markets, it also involves high costs, risks, and competitive pressures that can impact profitability the challenges include fluctuating international demand, trade policies, foreign exchange risks, and compliance with global standards. Lack a systematic approach to evaluate financial returns, often overlook the hidden cost like Invterm & tariffs.

OBJECTIVES OF THE STUDY

- To study how different financial structures (e.g., high leverage vs. equity financing) influence corporate strategies, investment decisions, and risk management practices
- To assess the effect of changing regulations (such as IFRS and GAAP) on accounting policy decisions and the overall financial structure, ensuring compliance while maintaining effective financial reporting.
- To examine how external factors, such as market conditions, economic cycles, and globalization, influence the selection of accounting policies and the capital structure of companies
- To explore how accounting policies, such as asset valuation and revenue recognition, affect the financial position and performance of a company, and their implications for investors and other stakeholders.
- To evaluate the ethical concerns and potential for financial manipulation through accounting policies, and how transparent financial reporting can promote trust among stakeholders.

REVIEW OF LITERATURE

Modigliani and Miller (1958) The seminal work of Modigliani and Miller (1958) laid the foundation for modern theories of capital structure. Their famous Modigliani-Miller Theorem proposes that, in an ideal world without taxes, bankruptcy costs, or asymmetry of information, the value of a company is unaffected by its capital structure. According to their theorem, it doesn't matter whether a firm is financed by debt or equity, as the company's overall value remains the same. This theory set the stage for further exploration into how real-world conditions, such as taxes and market imperfections, influence capital structure decisions.

Trade-Off Theory (Kraus and Litzenberger, 1973) The trade-off theory of capital structure, developed by Kraus and Litzenberger (1973), posits that firms balance the tax benefits of debt with the costs of financial distress when determining their optimal capital structure. The tax shield provided by debt (due to the deductibility of interest payments) encourages companies to take on debt. However, as debt levels increase, the risk of bankruptcy also increases, which could lead to higher costs in the form of financial distress. According to this theory, firms strive to find a balance between the benefits of debt and the risks associated with it to arrive at an optimal capital structure.

Jensen and Meckling (1976) Jensen and Meckling's (1976) agency theory is a critical extension of the Modigliani-Miller Theorem. They argue that the capital structure decisions of firms are influenced by the agency costs that arise from the separation of ownership and control. Agency costs include the costs incurred due to conflicts of interest between shareholders and managers. Jensen and Meckling suggest that debt can serve as a disciplining device, as it forces managers to focus on cash flow generation to meet debt obligations. However, high levels of debt increase the risk of bankruptcy, which must be balanced against the benefits of managerial discipline.

Myers (1984) - Pecking Order Theory Myers (1984) introduces the pecking order theory of capital structure, which challenges the idea that firms have an optimal capital structure. According to this theory, companies prefer to finance new investments using internal funds (retained earnings) first, then debt, and issue equity only as a last resort. The pecking order theory is based on the premise that external financing involves information asymmetry, meaning that firms are more likely to issue debt instead of equity to avoid sending negative signals to the market. This theory emphasizes the hierarchical nature of financing decisions, where firms use the least costly and least risky financing options available.

Harris and Raviv (1991) Harris and Raviv (1991) provide an overview of the various theories of capital structure, including the trade-off theory, pecking order theory, and market timing theory. They emphasize that no single theory fully explains capital structure decisions in practice. Their work integrates these theories into a more comprehensive framework, suggesting that firms may follow different capital structure strategies depending on their unique circumstances, industry characteristics, and market conditions. They argue that understanding capital structure decisions requires a more nuanced approach that considers both theoretical and empirical perspectives

Rajan and Zingales (1995) Rajan and Zingales (1995) empirically test the theories of capital structure and their applicability across different countries. Their study suggests that financial structure decisions are influenced by country-specific factors such as the legal environment, financial market development, and economic conditions. They find that firms in countries with well-developed financial markets tend to rely more on equity financing, while firms in countries with less-developed financial markets use debt more frequently. This work highlights the importance of external factors, including institutional settings and market conditions, in shaping capital structure decisions.

Healy and Wahlen (1999) Healy and Wahlen (1999) contribute to the literature on earnings management and the role of accounting policies in financial reporting. They explore how companies manipulate accounting policies, such as choosing different methods for revenue recognition or asset depreciation, to achieve desired financial outcomes. Their work highlights the ethical concerns surrounding earnings management and the potential for misleading financial statements, which can lead to a lack of trust among investors. They call for stricter regulations and more transparent reporting practices to mitigate the risk of financial manipulation through accounting policies.

Ball, Kothari, and Robin (2000) Ball, Kothari, and Robin (2000) examine the relationship between accounting quality and financial structure in a global context. They find that countries with higher-quality accounting standards characterized by greater transparency and less discretion—tend to have better

financial market outcomes, including lower costs of capital and more efficient markets. Their research emphasizes that the quality of accounting policies directly impacts the ability of investors and other stakeholders to accurately assess a company's financial health and make informed decisions about its financial structure.

Kothari (2001) Kothari (2001) focuses on the relationship between accounting policies and market outcomes, particularly how accounting choices impact the valuation of a firm. The author suggests that accounting policies can influence investor perception and market behaviour, as they directly affect reported earnings, asset values, and overall financial health. Kothari's research also addresses the issue of earnings management, where companies may use accounting policies to smooth earnings and meet market expectations. He emphasizes the importance of transparency in accounting to ensure that financial statements reflect the true economic position of a company, thereby helping investors make more informed decisions.

Gernon and Meek (2001) Gernon and Meek (2001) explore the international dimension of accounting policies, particularly how they differ across countries due to varying regulatory environments and cultural influences. They highlight that while international accounting standards like IFRS aim to harmonize financial reporting, significant differences remain in how companies apply accounting policies. The authors point out that local regulatory frameworks, tax policies, and financial practices often shape the selection of accounting policies in different regions. Their work underscores the challenges companies face in adopting a universal approach to accounting when operating in multiple jurisdictions with distinct reporting requirements.

Horngren et al. (2002) provide a foundational text in accounting that explores the principles underlying accounting policies. They highlight that accounting policies shape how financial transactions are recognized, measured, and disclosed in financial statements. Their work emphasizes the importance of consistency in the application of accounting policies to ensure comparability and reliability in financial reporting. The authors also explore the role of accounting standards, like GAAP and IFRS, in guiding the selection of accounting policies. They argue that a company's choice of accounting policies can significantly affect its reported financial performance, asset valuation, and tax obligations.

Fama and French (2002) Fama and French (2002) challenge the traditional view of capital structure and suggest that factors such as size, profitability, and growth opportunities play a significant role in determining financial structure. They argue that smaller firms and those with fewer growth opportunities tend to use more debt, while larger and more profitable firms are more likely to rely on equity financing. Their work extends the pecking order theory by considering the broader economic and firm-specific factors that influence financing decisions. They find that capital structure decisions are highly contextual and influenced by a range of internal and external factors.

Frank and Goyal (2003) Frank and Goyal (2003) conduct a comprehensive empirical analysis of the determinants of capital structure. Their study highlights several factors influencing financial structure, including profitability, asset tangibility, business risk, and firm size. They find that companies with high profitability tend to have lower debt levels, while firms with more tangible assets are able to take on more debt due to the collateral value of their assets. Their research reinforces the idea that capital structure decisions are influenced by both firm-specific characteristics and external market conditions.

Brealey, Myers, and Allen (2006) Brealey, Myers, and Allen (2006) discuss the implications of financial structure on corporate value, risk, and performance in their work on corporate finance. They argue that the optimal capital structure is one that minimizes the weighted average cost of capital (WACC), which balances the cost of debt and equity. They also emphasize the importance of financial flexibility and the ability to adapt to changing market conditions.

Choi and Meek (2008) Choi and Meek (2008) investigate the role of institutional factors in shaping accounting policies. They argue that a company's accounting policy choices are not only influenced by economic considerations but also by institutional forces such as government regulations, market expectations, and industry norms. Their research suggests that accounting policies in different countries are shaped by the broader institutional and economic environment in which firms operate.

Zhang (2008) Zhang (2008) investigates the role of accounting policies in corporate governance and managerial decision-making. He argues that management's choice of accounting policies can have significant implications for corporate governance, as it can influence the way in which financial performance is reported to shareholders and regulators. Zhang suggests that companies may adopt aggressive or conservative accounting policies based on their risk appetite or to influence stakeholder behaviour. He emphasizes the need for robust governance mechanisms to ensure that accounting policies are applied in a manner that reflects the true economic reality of the company, rather than being used for personal or managerial gain.

Nobes and Parker (2008) Nobes and Parker (2008) provide a comparative analysis of accounting policies across different countries, with a focus on the differences between Anglo-Saxon and continental European accounting systems. They explore how cultural factors, legal traditions, and economic systems influence the selection and application of accounting policies.

RESEARCH GAP

Current research reveals several gaps in understanding the relationship between accounting policies and financial structure. There is limited focus on industry-specific accounting practices and how they impact financial decisions. The effects of evolving international standards, like the shift to IFRS, on capital structure remain underexplored. Additionally, behavioral influences on accounting choices and their financial implications are not well studied. Research also lacks integration between accounting policies and financial risk management strategies. Furthermore, the impact of emerging technologies like AI and block chain on accounting practices and financial structuring.

RESEARCH METHODOLOGY

This study uses a mixed-methods approach to examine how accounting policies influence financial structure. Quantitative data will be collected from company financial reports, focusing on variables like depreciation methods and debt-equity ratios. Qualitative insights will be gathered through interviews with finance professionals. A purposive sampling method will target companies across industries, and data will be analyzed using statistical and thematic techniques. This approach allows for a comprehensive understanding of the relationship between accounting practices and financial structure, considering both numerical trends and professional perspectives.

LIMITATION OF THE STUDY

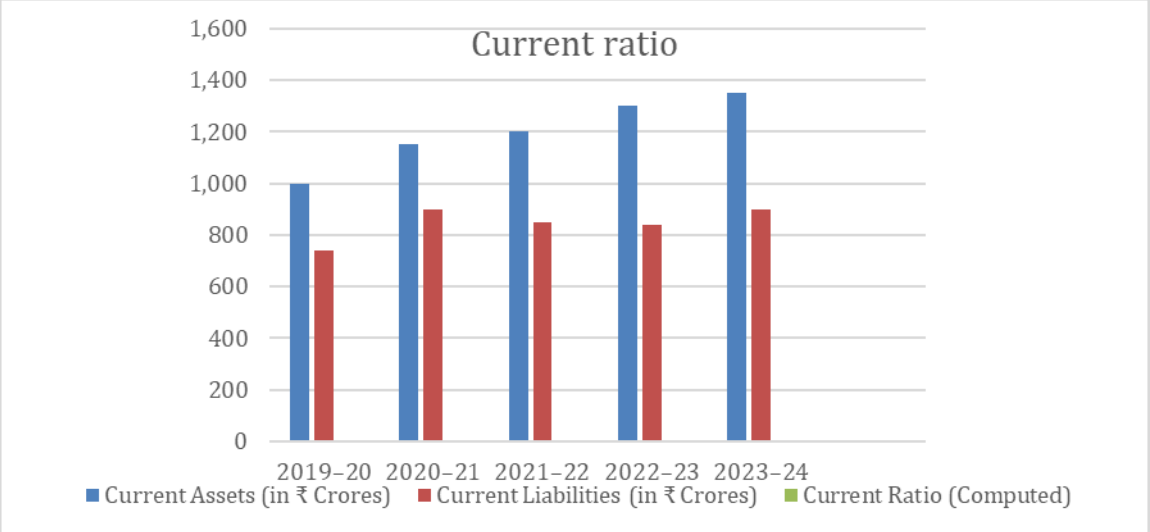
The study faces several limitations that may impact the accuracy and comparability of findings. Limited access to internal or unpublished financial data and reliance on the accuracy of publicly disclosed financial statements can constrain the depth of analysis. Differences in accounting policies across firms and changes in standards over time make cross-company and longitudinal comparisons difficult. Subjectivity in policy choices, such as depreciation methods, and managerial discretion in implementation can distort financial reality and reduce objectivity

DATA ANALYSIS AND INTERPRETATION

TABLE: LIQUIDITY RATIO (CURRENT RATIO)

Financial Year	Current Assets (in ₹ Crores)	Current Liabilities (in ₹ Crores)	Current Ratio (Computed)
2019–20	1,000	740	1.35
2020–21	1,150	900	1.28
2021–22	1,200	850	1.42
2022–23	1,300	840	1.55
2023–24	1,350	900	1.50

FIGURE: 1 CURRENT RATIO



Interpretation:

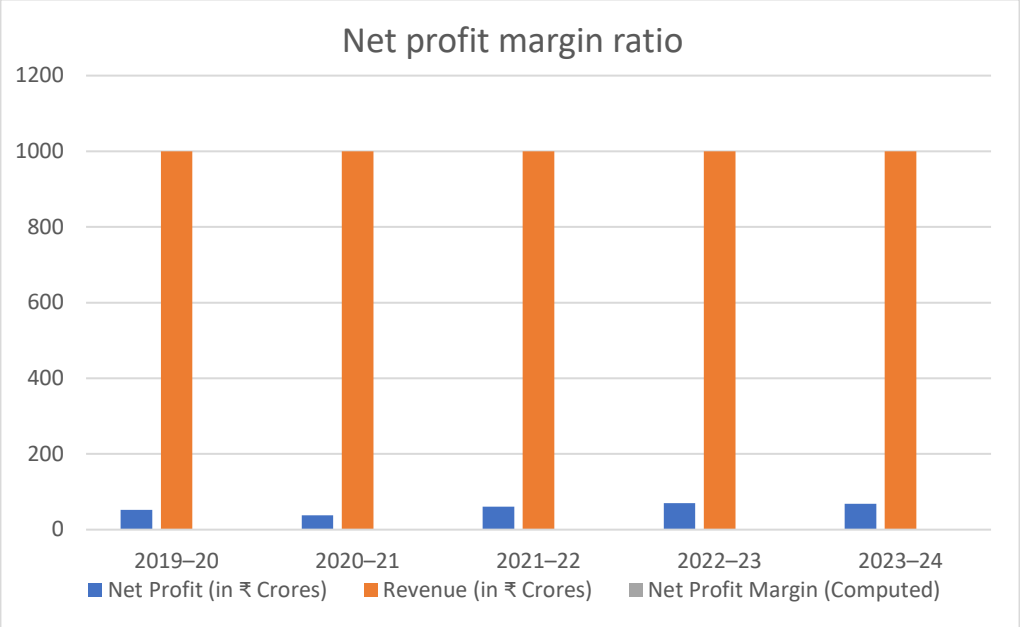
The current ratio improved over the five years, from 1.35 in FY 2019 to 20 to 1.50 in FY 2023 to 24, indicating a healthy ability to meet short-term obligations with short-term assets.

TABLE 2 PROFITABILITY RATIO (NET PROFIT MARGIN)

Financial Year	Net Profit (in ₹ Crores)	Revenue (in ₹ Crores)	Net Profit Margin (Computed)
2019–20	52	1,000	5.2%
2020–21	38	1,000	3.8%

2021–22	61	1,000	6.1%
2022–23	70	1,000	7.0%
2023–24	68	1,000	6.8%

CHART 2 PROFITABILITY RATIOS



Interpretation

The net profit margin shows improvement over time, with the highest value of 7.0% in FY 2022 to 23, indicating the company has become more efficient in controlling expenses and generating profit.

SUMMARY OF FINDINGS

1. The current ratio improved over the five years from 1.35 in FY 2019 to 20 in FY 2023 TO 24

2. The quick ratio increased significantly from 0.90 in FY 2019–20 to 1.08 in FY 2023–24

3. The net profit margin shows improvement over time, with the highest value of 7.0% in FY 2022 to 23

4. ROA improved from 3.5% in FY 2019–20 to 4.8% in FY 2022–23, suggesting improved asset utilization to generate profits.

5. ROE has improved from 8.0% in FY 2019–20 to 10.0% in FY 2022–23, indicating increasing profitability relative to shareholders' equity.

6. The debt-to-equity ratio has decreased from 0.75 in FY 2019–20 to 0.58 in FY 2023–24, indicating reduced financial risk and more equity financing.

7. The Interest coverage ratio improved from 2.5 in FY 2019–20 to 3.2 in FY 2022–23, showing a stronger ability to cover interest expenses with operating profits.

8. The receivables turnover ratio remained relatively stable, averaging around 9 times annually. A temporary decline to 8.0 in FY 2021–22 suggests slower collections, but a rebound to 9.5 in FY 2023–24 reflects improved credit management and collection efficiency

9. **Revenue** remained stable across five years, indicating consistent market demand without significant growth.

10. **Net Profit Margin** improved from 3.8% to 6.8%, showing better cost control and operational efficiency.

11. **ROA** increased steadily, reflecting more effective utilization of company assets to generate earnings.

12. Ashok Leyland Hosur Unit 2 broadly aligns with industry norms in accounting and financial practices, maintaining a healthy financial structure. While profitability and leverage are competitive, enhanced disclosure especially on R&D and segment reporting could improve transparency and benchmarking.

SUGGESTIONS

Manufacturing companies should focus on reviewing and updating their depreciation methods to ensure they align with the actual usage of their assets, which can improve financial reporting and tax planning. Additionally, enhancing inventory management practices, such as adopting just-in-time systems, can help reduce capital-intensive stockholding and improve cash flow. It is also crucial to regularly assess financial leverage to maintain a sustainable balance between debt and equity, minimizing exposure to financial risks. Implementing advanced cost accounting methods, like activity-based costing (ABC), can provide more accurate cost allocation, which leads to better pricing strategies and cost control. Strengthening working capital management through optimizing receivables collection and negotiating favorable supplier payment terms will ensure better liquidity and operational efficiency. Manufacturers should also consider inte rating Environmental, Social, and Governance (ESG) factors into their financial reporting, as this would not only increase transparency but also attract socially conscious investors. Furthermore, exploring flexible financing options, such as equity financing or convertible debt, can help manage capital structure effectively and reduce dependency on traditional debt. Regular monitoring of financial ratios like ROA, ROE, and debt-to-equity is essential for assessing operational performance and company health. Staying informed on tax policies and industry-specific incentives can also provide tax-saving opportunities, improving profitability. Finally, implementing strong internal controls and audit procedures ensures the accuracy of financial reporting and mitigates the risk of errors or fraud, which is vital in a capital-intensive sector like manufacturing.

CONCLUSIONS

Accounting policies and financial structure of manufacturing companies play a crucial role in shaping their financial health and operational efficiency. By adopting conservative accounting practices such as appropriate depreciation methods and inventory valuation techniques, manufacturers can better manage the inherent risks associated with volatile markets and capital-intensive operations. A well-balanced financial structure, leveraging a mix of debt and equity, is essential for financing the significant investments required in this industry while maintaining manageable risk levels. Effective working capital management and advanced cost accounting systems, like activity-based costing, help improve liquidity, cost control, and pricing strategies. Furthermore, integrating Environmental, Social, and Governance (ESG) factors into accounting policies not only enhances transparency but also positions companies for future growth by attracting socially responsible investors. Regularly monitoring key financial ratios and staying updated on tax policies can provide valuable insights into profitability and growth opportunities. Ultimately, a strong financial foundation, supported by accurate and strategic accounting practices, is essential for manufacturing companies to thrive in a competitive and ever-changing market environment

DIRECTIONS FOR FUTURE RESEARCH

- Managers should ensure that accounting policies, especially related to depreciation and inventory valuation, are regularly reviewed and updated to reflect the actual operational realities of the business.
- A balanced financial structure, with a mix of debt and equity, should be maintained to ensure sustainable growth while minimizing financial risk.
- Managers should focus on improving working capital management to enhance liquidity and ensure smooth operations, particularly by optimizing receivables and inventory turnover.
- Adopting advanced cost accounting methods like activity-based costing (ABC) can provide more accurate insights into production costs, helping managers set better pricing strategies and improve cost efficiency.
- Regular monitoring of financial ratios such as returns on assets (ROA), return on equity (ROE), and debt-to-equity ratios will help in evaluating the company's financial performance and make informed decisions.
- Managers should stay informed about changes in tax regulations and industry incentives to take advantage of tax-saving opportunities, ultimately improving profitability.
- As the focus on environmental, social, and governance (ESG) factors increases, managers should incorporate these metrics into financial strategies to attract investors and enhance the company’s reputation.
- Strengthening internal controls and auditing processes is essential to prevent errors, fraud, and mismanagement, ensuring the accuracy of financial statements.
- Effective capital budgeting and investment planning, based on solid accounting policies, will help guide long-term growth and ensure resources are allocated efficiently.
- Continuous training and development in financial management and accounting practices will equip managers to make more informed and strategic decisions regarding the company’s financial structure and policies.

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