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CA INTER

FINANCIAL MANAGEMENT

Version 4

MAY 26 & ONWARDS

Handwritten Concept Book

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CA AMIT SHARMA

01 CHAPTER INTRO TO FINANCIAL MANAGEMENT

In layman language we can say that FM is made up of two terms :-

Finance

Management

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Financial Management is that managerial activity which is concerned with planning and controlling of Finances. Or we can also say that it is related to management of Inflows & Outflows of Funds and includes 3 decisions:-

- WHERE TO GET THE FUNDS FROM
  - Equity
  - Preference
  - Debentures
- WHERE TO INVEST THE FUNDS
  - Capital expenditure
  - Working capital
- HOW MUCH DIVID TO BE PAID

1 PROFIT & LOSS STATEMENT

SALES	XX
− Cost of goods sold [COGS]	(XX)
GROSS PROFIT	XX
− Operating expenses (admin, selling & distr. exp)	(XX)
EARNINGS BEFORE INT & TAX [EBIT] or [Operating profit]	XX
− Interest expenses	(XX)
EARNINGS BEFORE TAX [EBT]	XX
− Tax expenses	(XX)
EARNINGS AFTER TAX [EAT] or [Net Profit]	XX
− Preference Dividend	(XX)
EARNINGS AVAILABLE TO EQUITY S/H [EATESH]	XX
− Equity Dividend	(XX)
Retained Earnings	XX

Sequence of payment

1. Interest to Debt Holders
2. Tax to Govt.
3. Pref. Divd to Pref S/Holder
4. Eq. Divid to Eq S/Holders

2 BALANCE SHEET

Equity share capital	xx	**Fixed Assets**	
Reserve and Surplus	xx	Plant	xx
Preference share capital	xx	Machine	xx
		Furniture	xx
Non Current Liability			
Debentures	xx	**Current Assets**	
Long term loan	xx	Inventory	xx
		Debtors	xx
Current Liability		Cash	xx
Creditors	xx	Bank	xx
Short term Loan	xx	Accumulated Loss	xx
Bank Overdraft	xx	Preliminary Expenses	xx
O/s expenses	xx	Advance pay of exp	xx
Advance Income	xx	Accrued Income	xx
	xxx		xxx

3 FINANCIAL ACCOUNTING V/S FINANCIAL MANAGEMENT

Financial Accounting generates info. relating to operations of organisation. The outcome of financial accounting is B/sheet, P/L and focuses on the accrual concept.

Financial Management use the information prepared by accounting dept. to take decisions wrt raising, investing funds focusing on actual pay or receipts.

NOTES

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02 CHAPTER — RATIO ANALYSIS

Mr BB earned ₹ 1 lakh and was superhappy

Mr AB also earned ₹ 75000 and was happy

Question 1 :- Who among the both is more happy ??

Obviously Mr BB earned more and is more happy ??

Let's go in detail :-

- Mr BB invested ₹ 500,000 and earned ₹ 100,000
- Mr AB invested ₹ 150,000 and earned ₹ 50,000

Ques :- Now tell me who is more happy ??

BB earned :- $\frac{₹\,100,000}{₹\,500,000} \times 100\%$ = 20% on his investment.

AB earned :- $\frac{₹\,75,000}{₹\,150,000} \times 50\%$ = 50% on his investment.

In short, sometimes comparison gives us the exact real scenario which can not be revealed by the numbers and this is where ratio analysis comes into play.

Ratio is reffered as expressing two numbers in form of P/Q and when two items of financial statement of company are compared in the similar manner to get some meaningful info, it is called as Ratio Analysis.

So simply all we do in ratio analysis is pick two items from Profit & Loss Statement or Balance Sheet and then we try to compare them.

TWO MOST IMPORTANT ELEMENTS OF RATIO ANALYSIS

Profit & Loss Statement | Balance Sheet

1 PROFIT & LOSS STATEMENT

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SALES	XX
− Cost of goods sold [COGS]	(XX)
GROSS PROFIT	XX
− Operating expenses (admin, selling & distr. exp)	(XX)
EARNINGS BEFORE INT & TAX [EBIT] or [Operating profit]	XX
− Interest expenses	(XX)
Earnings before Tax [EBT]	XX
− Tax expenses	(XX)

Earnings After Tax [EAT] or [Net Profit]	xx
− Preference Dividend	(xx)
Earnings Available To Equity S/H [EATESH]	xx
− Equity Dividend	(xx)
Retained Earnings	xx

2 Balance Sheet

Equity share capital	xx	**Fixed Assets**	
Reserve and Surplus	xx	Plant	xx
Preference share capital	xx	Machine	xx
		Furniture	xx
Non Current Liability			
Debentures	xx	**Current Assets**	
Long term loan	xx	Inventory	xx
		Debtors	xx
Current Liability		Cash	xx
Creditors	xx	Bank	xx
Short term Loan	xx	Accumulated Loss	xx
Bank Overdraft	xx	Preliminary Expenses	xx
O/s expenses	xx	Advance pay of exp	xx
Advance Income	xx	Accrued Income	xx
	xxx		xxx

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Let's understand some common confusing points

Total Assets	Capital Employed	Equity S/h Fund	Networth (or) S/h equity (or) Proprietary Ratio

Total Assets :- All the assets of the organisation or the asset side of the balance sheet and since in balance sheet, the aset side equals liability side so we can also say total of liability side

Fixed Assets + Current Assets

Capital Employed :- Simply reffers to the total capital employed by the firm.

Equity + R/surplus + Debentures + Pref s/cap

(minus any preliminary exp or accumulated loss)

But, we can also calculate it from ASSETS SIDE

Fixed Assets + Current Assets − Current Liab

Equity s/holders Fund :- Reffers to funds invested by Equity s/holders only

Equity share capital + Reserves & Surplus

(minus any preliminary exp or accumulated loss)

Networth (or) Propietary Funds (or) S/holders Equity :- All have same meaning i.e what are the funds given by equity and pref s/holders.

Equity + R/surplus + Pref s/cap
(minus any preliminary exp or accumulated loss)

But, we can also calculate it from ASSETS SIDE

Fixed Assets + Current Assets − Current Liability − Non-Current Liability

3 PROFITABILITY RATIOS (BASED ON SALES)

BASIC TRICK :- $\frac{\text{Any Income or Expense}}{\text{Sales}} \times 100\%$

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- Gross Profit Ratio = $\frac{\text{G. profit}}{\text{Sales}} \times 100\%$
- Pre-Tax Profit Ratio = $\frac{\text{EBT}}{\text{Sales}} \times 100\%$
- Operating Profit Ratio = $\frac{\text{EBIT}}{\text{Sales}} \times 100\%$
- Operating Ratio = $\frac{\text{COGS} + \text{Op. Exp}}{\text{Sales}} \times 100\%$
- Net Profit Ratio = $\frac{\text{Net Profit}}{\text{Sales}} \times 100\%$
- COGS Ratio = $\frac{\text{COGS}}{\text{Sales}} \times 100\%$
- Operating Exp Ratio = $\frac{\text{Operat. Exp}}{\text{Sales}} \times 100\%$
- Financial Expenses Ratio = $\frac{\text{Fin. Exp}}{\text{Sales}} \times 100\%$

4 PROFITABILITY RATIOS (BASED ON RETURN)

BASIC TRICK :- $\frac{\text{What you earned}}{\text{What you invested}}$ times

- Return on Equity = $\frac{\text{Earnings available to eq.s/holders}}{\text{Equity shareholders fund}}$
- Return on Capital Employed = $\frac{\text{Earnings before Interest \& Tax}}{\text{Total capital employed}}$
- Return on Assets = $\frac{\text{Earnings after tax}}{\text{Total Assets}}$ = $\frac{\text{EBIT} - \text{tax \%}}{\text{Total Assets}}$
- Return on Investment = $\frac{\text{Profit}}{\text{Investment}}$

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5 PROFITABILITY RATIOS (OWNER'S P.O.V)

Earnings Per Share (EPS)	Dividend Per Share (DPS)	Dividend Payout
$\frac{\text{Earnings avail. to eqs/h}}{\text{Total no. of eq. shares}}$	$\frac{\text{Total divid paid to eqs/h}}{\text{Total no. of eq. shares}}$	$\frac{\text{DPS}}{\text{EPS}}$

6 PROFITABILITY RATIOS
(RELATED TO MARKET)

- Price to Earnings (P/E) $\frac{MPS}{EPS}$
- Dividend Yield $\frac{DPS}{MPS}$
- Earnings Yield $\frac{EPS}{MPS}$

7 ACTIVITY RATIOS
(TURNOVER RATIO)

BASIC TRICK :- $\frac{\text{Sales}}{\text{Whose T/O Asked}}$ times

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- Assets T/O Ratio = $\frac{\text{Sales}}{\text{Total Assets}}$
- Fixed Assets T/O Ratio = $\frac{\text{Sales}}{\text{Fixed Assets}}$
- Capital T/O Ratio = $\frac{\text{Sales}}{\text{Total Capital}}$
- Working Cap T/O Ratio = $\frac{\text{Sales}}{\text{Working capital}}$

But there are three exceptions to the above rule :-

Inventory T/O Ratio
$\frac{\text{COGS}}{\text{Inventory}}$

Receivable T/O Ratio
$\frac{\text{Credit Sales}}{\text{Debtors + Bill·Rec}}$

Payables T/O Ratio
$\frac{\text{Credit Purchases}}{\text{Creditors + Bills·Pay}}$

Debtors T/O Ratio
$\frac{\text{Credit Sales}}{\text{Debtors}}$

Creditors T/O Ratio
$\frac{\text{Credit Purchases}}{\text{Creditors}}$

If opening and closing are given then use average Invent/Deb·/Cred·

8 COVERAGE RATIOS

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BASIC TRICK :- $\frac{\text{Earnings to cover}}{\text{What to cover}}$ times

- Interest Coverage Ratio = $\frac{\text{Earnings Before Interest \& Tax}}{\text{Interest}}$
- Eq· Dividend Coverage Ratio = $\frac{\text{Earnings Available to Eq· s/holder}}{\text{Equity Dividend}}$
- Pref. Dividend Coverage Ratio = $\frac{\text{Earnings After Tax}}{\text{Preference Divid}}$

- Debt Service Coverage Ratio = $\frac{\text{Earnings Before Interest \& Tax}}{\text{Interest + Installment}}$

- Fixed Charge Coverage Ratio = $\frac{\text{EBIT + Depreciation}}{\text{Interest + Installment}}$

9 SHORT-TERM SOLVENCY RATIOS

It means ability of the business to pay its Short-term liabilities. It is also reffered to as the liquidity. Also lack of sufficient liquidity or excess liquidity is bad for the organisation.

- Current Ratio = $\frac{\text{Current Assets}}{\text{Current Liability}}$ — whether the organsiation has enough CA to pay CL. The optimum ratio is 2:1

- Quick Ratio = $\frac{\text{CA − Prepaid Exp − Inventory}}{\text{Current Liability}}$ — Optimum ratio is 1:1, also called as Acid Test Ratio

- Cash Ratio = $\frac{\text{Cash/Bank + Marketable Invest}}{\text{Current Liability}}$

- Basic Defence Interval = $\frac{\text{CA − Prepaid Exp − Inventory}}{\text{Daily operating exp}}$

Daily Operating Expense = $\frac{\text{COGS + Operating Expenses}}{\text{360 Days}}$

- Net Working Capital = Current Assets − Current Liability

10 LONG - TERM SOLVENCY RATIOS

This ratio measures the long-term stability and capital structure of the firm. It shows mix of funds given by owners & lenders and assure the lenders about periodic payment of Interest and Principal Payment.

$$\text{Equity Ratio} = \frac{\text{Shareholder's Equity}}{\text{Total Capital}}$$

$$\text{Debt Ratio} = \frac{\text{Total Debt}}{\text{Total Capital}}$$

$$\text{Debt Ratio} = \frac{\text{Total Debt}}{\text{Total Capital}}$$

$$\text{Debt to Equity Ratio} = \frac{\text{Debt}}{\text{Equity}}$$

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$$\text{Debt to Total Assets} = \frac{\text{Debt}}{\text{Total Assets}}$$

$$\text{Proprietary Ratio} = \frac{\text{Proprietary Fund}}{\text{Total Assets}}$$

DU-PONT ANALYSIS

$$\text{Return on Equity} = \frac{\text{Net Profit}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Total Assets}} \times \frac{\text{Total Assets}}{\text{Eq s/holders Fund}}$$

$$(\text{ROE}) = \text{Net profit ratio} \times \text{Assets T/O} \times \text{Equity Multiplier}$$

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CA Inter Fianancial Management Concept Book

Clear COST-FM-SM with Amit Sharma

- Cleared All levels of CA in First Attempt.
- Secured AIR 30 in CA Inter.
- Articleship from one of the Big 4s (KPMG) & awarded with best performance on the first project.
- Industrial training from one of the top Investment Banking firm (Goldman Sach) in FPnA domain. Hence implementing practicing concepts of Cost FM & SM.

Book Highlights:

- The only single material for your exemption
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- Prepared in most concise & student friendly manner
- Best Material for First Time Learner - subsequent revision-Final 1.5 Days revision
- Covering all the amendments & concepts for the new course

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