FINANCIAL MANAGEMENT
IN
GENERAL
BY

DR. K.SWAMY
PROFESSOR,
DR. MCR HRD INSTITUTE

What is Management ?

- Money
- Men
- Materials
- Machines

Why Financial Management ?

- Timely Supply of Money
- Economical Rate of Interest
- Effective use of Finances
- Realize ROI

Objectives of Financial Management

- Profit Maximization
- Wealth Maximization

$$\mathbf{W} = \frac{A_1}{(1+K)^1} + \frac{A_2}{(1+K)^2} + \ldots\ldots + \frac{A_n}{(1+K)^n} - C$$

Here:

W=Wealth, **K**= Cost of Capital,

C= Initial investment /cash outflow

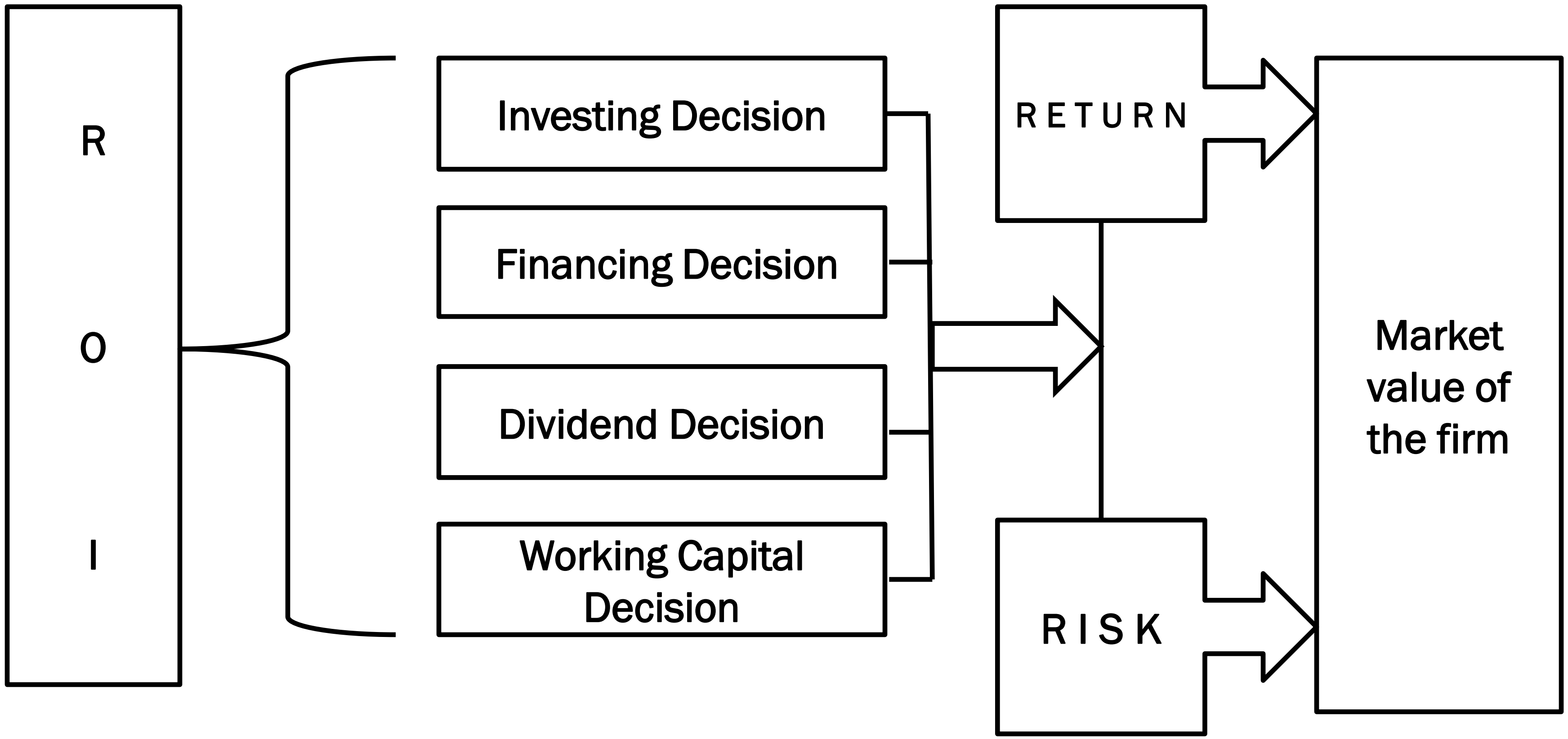
A1,A2,…,An = Streams of Annual cash inflow

Ex: Each of the following Projects requires 10 lakhs
The following are the Profits at the end of each year in lakhs. Which Project you prefer and Why? Rank them.

Projects

Profit	A	B	C
1^{st} Year	1,00,000/-	5,00,000/-	3,00,000/-
2^{nd} Year	3,00,000/-	4,00,000/-	4,00,000/-
3^{rd} Year	4,00,000/-	3,00,000/-	5,00,000/-
4^{th} Year	5,00,000/-	1,00,000/-	1,00,000/-
Total (Rs.)	13,00,000/-	13,00,000/-	13,00,000/-

Functions of Financial Management



Accounting Information for Decision Making

Accounting

Vs

Financial Management

Accounting
&
Users of Accounting Information

Steps in Accounting Process

1. Understand Accounting Principles
2. Write Journal Entries
3. Ledger Posting
4. Balancing the Ledger
5. Subsidiary Books
6. Prepare trail Balance
7. Financial Statements

Accounting Concepts

- Business Entity Concept
- Going Concern Concept
- Money Measurement Concept
- Cost Concept
- Accounting Period Concept

Continued

- Dual Aspect Concept
- Matching Concept
- Realization Concept
- Balance Sheet Equation Concept

Accounting Conventions

1. Disclosure
2. Materiality
3. Consistency
4. Conservatism

GAAP Vs IFRS

Branches of Accounting

1. Financial Accounting
2. Cost Accounting
3. Management Accounting

Classification of Accounts

Personal Accounts

Debit the Receiver
Credit the Giver

Impersonal Accounts

Real A/C

Debit What Comes in
Credit What Goes Out

Nominal A/C

Debit all Expenses & Losses
Credit all Income & Gains

Self Check

- Land
- Gopi
- Cash
- Furniture
- Tele-Phone Bill
- Tele-Phone
- Goods
- Salary
- Machinery
- Stationary
- Inventory

JOURNAL FORMAT

1 Date	2 Particulars	3 L.F	4 Dr Amount Rs	5 Cr Amount Rs

LEDGER FORMAT

Dr Cr

Date	Particulars	L.F	Amount Rs	Date	Particulars	L.F	Amount Rs

FORMAT OF PURCHASE /SALES BOOK

1 Date	2 Particulars	3 L.F	4 Details Rs	5 Amount Rs

Debit Note
Credit Note

Practical Problems

2014

April

		Rs
1	Mishra Commenced business with cash	1,50,000/-
1	Purchased a motor truck	50,000/-
2	Purchased goods from Ahmed	20,000/-
3	Sold goods	1,000/-
4	Returned goods to Ahmed	500/-
7	Sold goods to Chand	2,500/-
8	Chand returned goods	100/-
11	Cash purchases	5,000/-
14	Purchased postage stamps	50/-

Continued...

		Rs
16	Paid for advertising	500/-
20	Paid office expenses	40/-
25	Drew cash for personal use	1,000/-
26	Cash sales	800/-
27	Paid insurance premium	200/-
30	Paid rent	1,000/-
30	Paid salaries	5,000/-

JOURNAL ENTRIES

April		Dr	Cr
1	Cash A/C Dr To Capital (Being Capital Introduced)	1,50,000	1,50,000
1	Motor Truck A/C Dr To Cash (MT Purchased)	50,000	50,000
2	Purchases A/C Dr To Ahammed (Credit Purchases)	20,000	20,000

Continued...

April		Dr	Cr
3	Cash A/C Dr To Sales (Cash Sales)	1000	 1000
4	Ahammed A/C Dr To Purchase Returns (Purchase Returns)	500	 500
7	Chand A/C Dr To Sales (Being Credit Sale)	2,500	 2,500

Continued...

April		Dr	Cr
8	Sales Returns A/C Dr To Chand A/C (Chand Returned Goods)	100	 100
11	Purchases A/C Dr To Cash (Being Cash Purchases)	5000	 5000
14	Postal Stamps A/C Dr To Cash (Postage Spent)	50	 50

Continued...

April		Dr	Cr
16	Advertising A/C Dr To Cash (Being Spent on Advertising)	500	 500
20	Office Expenses Dr To Cash (Office Expenses)	40	 40
25	Drawing A/C Dr To Cash (Cash With Drawn for Personal)	1000	 1000

Continued...

April		Dr	Cr
26	Cash A/C Dr	800	
	To Sale		800
	(Cash Sales)		
27	Insurance Premium A/C Dr	200	
	To Cash		200
	(Premium Paid)		
30	Rent A/C Dr	1000	
	To Cash		1000
	(Rent Paid)		
30	Salaries A/C Dr	5000	
	To Cash		5000
	(Salaries Paid)		

LEDGER ACCOUNTS

CASH ACCOUNT

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
	To Capital	-	1,50,000/-		By Moto r Truck	-	50,000/-
	‘’ Sales	-	1,000/-		‘’ Purchases	-	5,000/-
	‘’ Sales	-	800/-		‘’ Postal	-	5,000/-
					‘’ Advertising	-	500/-
					‘’ Office Expenses	-	40/-
					‘’ Drawing	-	1,000/-
					‘’ Premium	-	200/-
					‘’ Rent	-	1,000/-
					‘’ Salaries	-	5,000/-
					‘’ Balance C/D	-	89,010/-
			1,51,800/-				1,51,800/-

Balance B/D 89,010

CAPITAL ACCOUNT

Date	Particulars	Amount	Date	Particulars	Amount
	To Balance C/D	1,50,000/-		By Cash	1,50,000/-
		1,50,000/-			1,50,000/-
				Balance B/D	1,50,000/-

CAPITAL ACCOUNT

Date	Particulars	Amount	Date	Particulars	Amount
	To Balance C/D	1,50,000/-		By Cash	1,50,000/-
		1,50,000/-			1,50,000/-
				Balance B/D	1,50,000/-

SALARIES ACCOUNT

Date	Particulars	Amount	Date	Particulars	Amount
	To Balance B/D	5,000/-		By Balance C/D	5,000/-
		5,000/-			5,000/-
	Balance B/D	5,000/-			

PURCHASES ACCOUNT

Date	Particulars	Amount	Date	Particulars	Amount
	To Ahammed	20,000/- 5,000/-		By Balance C/D	25,000/-- -
		25,000/-			25,000/-
	Balance B/D	25,000/-			

SALES ACCOUNT

Date	Particulars	Amount	Date	Particulars	Amount
	To Balance C/D	4,300/-		By Cash	1,000/-
		-		Chand	2,500/-
		-		Cash	800/-
		4,300/-			4,300/-
				Balance B/D	4,300/-

PURCHASE RETURNS

Date	Particulars	Amount	Date	Particulars	Amount
	To Balance C/D	500/-		To Ahammed	500/-
		500/-			500/-
				Balance B/D	500/-

SALES RETURNS

Date	Particulars	Amount	Date	Particulars	Amount
	To Chand	100/-		By Balance C/D	100/-
		100/-			100/-
	Balance B/D	100/-			

AHAMMED ACCOUNT

Date	Particulars	Amount	Date	Particulars	Amount
	Purchases Returns	500/-		By Purchase	20,000/-
		19,500/-			
	Balance C/D	20,000/-			20,000/-
				Balance B/D	19,500/-

CHAND ACCOUNT

Date	Particulars	Amount	Date	Particulars	Amount
				Sales Returns	100/-
	To Sales	2,500/-		Balance C/D	2,400/-
		2,500/-			2,500/-
	Balance B/D	2,400/-			

RENT ACCOUNT

Date	Particulars	Amount	Date	Particulars	Amount
	Cash	1000/-		Balance C/D	1000/-
		1000/-			1000/-
	Balance B/D	1000/-			

MOTOR TRUCK ACCOUNT

Date	Particulars	Amount	Date	Particulars	Amount
	Cash	50,000/-		Balance C/D	50,000/-
		50,000/-			50,000/-
	Balance B/D	50,000/-			

POSTAGE ACCOUNT

Date	Particulars	Amount	Date	Particulars	Amount
	Cash	50/-		Balance C/D	50/-
		50/-			50/-
	Balance B/D	50/-			

ADVERTISING ACCOUNT

Date	Particulars	Amount	Date	Particulars	Amount
	Cash	500/-		Balance C/D	500/-
		500/-			500/-
	Balance B/D	500/-			

OFFICE EXPENSES ACCOUNT

Date	Particulars	Amount	Date	Particulars	Amount
	Cash	40/-		Balance C/D	40/-
		40/-			40/-
	Balance B/D	40/-			

DRAWINGS ACCOUNT

Date	Particulars	Amount	Date	Particulars	Amount
	Cash	1000/-		Balance C/D	1000/-
		1000/-			1000/-
	Balance B/D	1000/-			

PREMIUM ACCOUNT

Date	Particulars	Amount	Date	Particulars	Amount
	Cash	200/-		Balance C/D	200/-
		200/-			200/-
	Balance B/D	200/-			

TRIAL BALANCE

Name of Account	Dr.	Cr.
	Rs.	Rs.
Cash	89,010/-	-
Capital	-	-
Motor Truck	50,000/-	1,50,000/-
Purchases	25,000/-	-
Sales	-	4,300/-
Purchase Returns	-	500/-
Sales Returns	100/-	-
Ahammed	-	19,500/-
Chand	2,400/-	-
Postage	50/-	-
Advertising	500/-	-

Continued...

Name of Account	Dr.	Cr.
	Rs.	Rs.
Office Expenses	40/-	-
Drawings	1,000/-	-
Insurance	200/-	-
Rent	1,000/-	-
Salaries	5,000/-	-
	1,74,300/-	1,74,300/-

TRADING ACCOUNT

Date	Particulars	Amount	Date	Particulars	Amount
	To Purchase (-) Returns	25,000/- 500/-		By Sales (-) Returns	4,300/- 100/-
		24,500/-			4,200/-
				Gross Loss	20,300/-
		24,500/-			24,500/-

P & L ACCOUNT

Date	Particulars	Amount	Date	Particulars	Amount
	Gross Loss	20,300/-		Net Loss	27,090/-
	Post	50/-			-
	Advertising	500/-			-
	Office Expenses	40/-			-
	Insurance	200/-			-
	Rent	1000/-			-
	Salaries	5000/-			-
		27,090/-			27,090/-

BALANCE SHEET
As on April 30th

Date	Particulars	Amount	Date	Particulars	Amount
	Capital	1,50,000/-		Cash	89,010/-
	(-) Drawings	1,000/-			
	(-) Net loss	27,090/-			
		1,21,910/-		Motor Truck	50,000/-
	Ahammed	19,500/-			
				Chand	2,400/-
		1,41,410/-			1,41,410/-

Adjustment Entries

FINANCIAL STATEMENT ANALYSIS

- Comparative Statement
- Common Size Statement
- Trend Analysis
- Ratio Analysis
- Cash Flow & Fund Flow Statements

RATIO ANALYSIS

A. Capital Structure Ratios

I. Debt- Equity Ratio $= \dfrac{Long\ term\ Debt}{Share\ holders\ equities}$

II. Debt- Equity Ratio $= \dfrac{Total\ Debt}{Share\ holders\ equities}$

III. Debt- Total Capital Ratio $= \dfrac{Long\ term\ Debt}{Permanent\ Capital}$

IV. Debt- Total Assets Ratio $= \dfrac{Total\ Debt}{Total\ Capital}$

Coverage Ratios

I. Interest coverage ratio $= \dfrac{EBIDT}{Interest}$

II. Dividend Coverage Ratio $= \dfrac{PAT}{Preference\ Divided}$

B. Liquidity Ratios

I. Current Ratio $= \frac{Current\ Assets}{Current\ Liabilities}$

II. Quick Ratio$= \frac{Current\ Assets-(Stock+Prepaid)}{Current\ Liabilities}$

III. Cash Position Ratio $= \frac{Current\ Assets-(Stock+Prepaid\ exp+Debtors)}{Current\ Liabilities}$

IV. Stock Turnover Ratio $= \frac{Cost\ of\ goods\ sold}{Average\ Inventory}$

V. Stock holding Period $= \frac{12m \; or \; 365 \; days}{STR}$

VI. Debtors Turnover Ratio $= \frac{Credit \; Sales}{Average \; Debtors}$

VII. Debt Collection Period $= \frac{12m \; or \; 365 \; days}{DTR}$

VIII. Creditors Turnover Ratio $= \frac{Credit \; Purchases}{Average \; Creditors}$

IX. Credit Payment Period $= \frac{12m \; or \; 365 \; days}{CTR}$

C. Profitability Ratios

I. GP Ratio $= \frac{G\ P}{Sales}$ X 100

II. Operating Profit Ratio $= \frac{EBIT}{Sales}$

III. Net Profit Ratio $= \frac{PAT}{Sales}$

IV. ROA $= \frac{NP}{Total\ Assets}$

V. ROCE= $\frac{N\ P}{Total\ Capital\ Employed}$

VI. EPS= $\frac{NP - Preference\ Dividend}{Number\ of\ Equity\ Shares}$

VII. DPS = $\frac{Dividend\ Paid\ to\ E.S}{Number\ of\ Equity\ Shares}$

VIII. Dividend – Pay out Ratio= $\frac{DPS}{EPS}$

IX. Earnings Yield= $\frac{EPS}{MPS}$

X. Dividend Yield $= \dfrac{DPS}{MPS}$

XI. Price Earning Ratio $= \dfrac{MPS}{EPS}$

XII. Earning Power $= \dfrac{NP}{Sales} X \dfrac{Sales}{Total\ Assets}$

$$= \frac{NP}{Total\ Assets}$$

ROI= (Net Profit Percentage) X (Investment Turnover)

Sales ÷ Total Assets

Example:

Trading Account of SONY Ltd.

To	Opening Stock		2,00,000/-
	Purchases	10,00,000/-	
	(-) Returns	1,00,000/-	
			9,00,000/-
	Wages		3,00,000/-
	Coal		2,00,000/-
	Gross Profit		12,00,000/-
			28,00,000/-

By	Sales	26,00,000/-	
	(-) Returns	1,00,000/-	
			25,00,000/-
	Closing Stock		3,00,000/-
			28,00,000/-

P & L Account
for the Year

To	Salaries		2,00,000/-		By	Gross Profit		12,00,000/-
	Administrative ex		1,00,000/-					
	Rent		50,000/-					
	Electricity		25,000/-					
	Postage		25,000/-					
	Telephone Bill		25,000/-					
	Selling Expenses		10,000/-					
	Travel Expenses		15,000/-					
	Depreciation		1,00,000/-					
	Interest		50,000/-					
	Tax		1,00,000/-					
	Net profit		5,00,000/-					
			12,00,000/-					12,00,000/-

Balance Sheet of SONY Ltd.
As on 31.12.2013

Capital + Liabilities

Equity Shares 10,000 @ 100 each		10,00,000/-	
9% Preference Shares		5,00,000/-	
Reserves		4,00,000/-	
10% Debentures		5,00,000/-	
Bank Over Draft		2,00,000/-	
Creditors		2,50,000/-	
Bills Receivables		1,75,000/-	
O/S Expenses		2,25,000/-	
		32,50,000/-	

Assets

Fixed Assets		10,00,000/-	
Investment		5,00,000/-	
Good Will		4,00,000/-	
Stock		3,00,000/-	
Debtor		5,00,000/-	
Bills Expenses		2,50,000/-	
Prepaid Expenses		1,00,000/-	
Cash		2,00,000/-	
		32,50,000/-	

I. An Amount of Rs.1,00,000/- Paid towards equity dividend

II. The market price of the shares is 150/-

Calculate Relevant Ratio

Cost Classification & Decision Making

What is Cost ?

Fixed – Semi Fixed

Variable – Semi Variable

Direct – Indirect

Product – Period

Controllable – Non controllable

Imputed Cost – Out of Pocket

Historical – Hypothetical

Opportunity – Capital Cost

Relevant Cost – Irrelevant Cost

Material	=	Direct	+	Indirect
+		+		+
Labour	=	Direct	+	Indirect
+		+		+
Other Exp	=	Direct	+	Indirect
‖		‖		‖
Total Cost	=	Prime Cost	+	Overhead

Cost Volume Profit Analysis

1. Sales – Variable Cost = Contribution
2. Fixed cost + Profit / Loss = Contribution
3. Sales – Variable cost = Fixed cost + Profit/Loss
4. P/V Ratio $= \frac{Contribution}{Sales}$ or $\frac{Change\ in\ Profit}{Change\ in\ Sales}$
5. Sales $= \frac{Contribution}{P/V\ Ratio}$
6. Contribution = P/V Ratio X Sales

7. BEP$= \frac{\boldsymbol{Fixed\ Cost}}{\boldsymbol{P/V\ Ratio}}\ \boldsymbol{or}\ \frac{\boldsymbol{Fixed\ Cost}}{\boldsymbol{Unit\ Contribution}}$

8. Margin of Safety = Actual Sales – BEP Sales

Example:

A Street Hawker runs a Tea Stall. The Expenditure likely to be incurred is as below.

Sl. No	Item	Rupees
1.	The Tea Powder per Cup	3/-
2.	Sugar per Cup	2/-
3.	Disposable Cup	1/-
4.	The Selling Price per Cup	10/-
5.	The Fixed Cost	400/-

Calculate :

1 P/V Ratio

2 BEP Sales

3 Sales to earn profit of Rs.500/-

4 Profit at Sales of Rs.3000/-

5 New BEP if the selling price goes up by 10%


Thank you