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

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

Here:

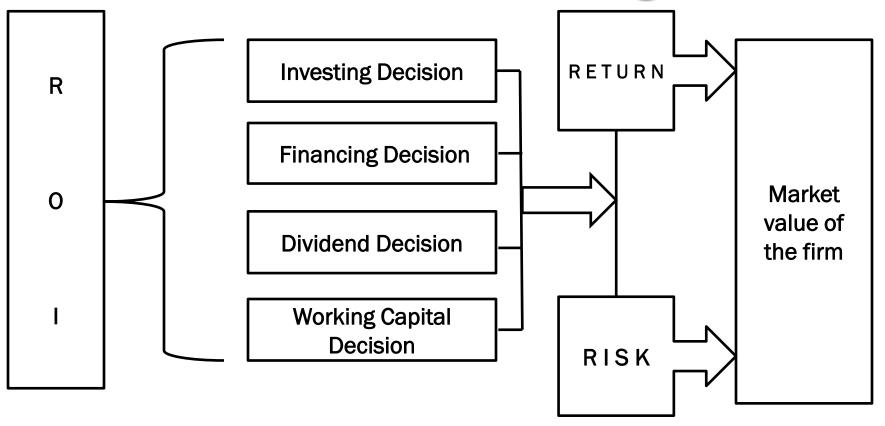
W=Wealth, K= Cost of Capital,
C= Initial investment / cash outflow
A1,A2,...,An = Streams of Annual cash inflow

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	Α	В	С
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

- 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

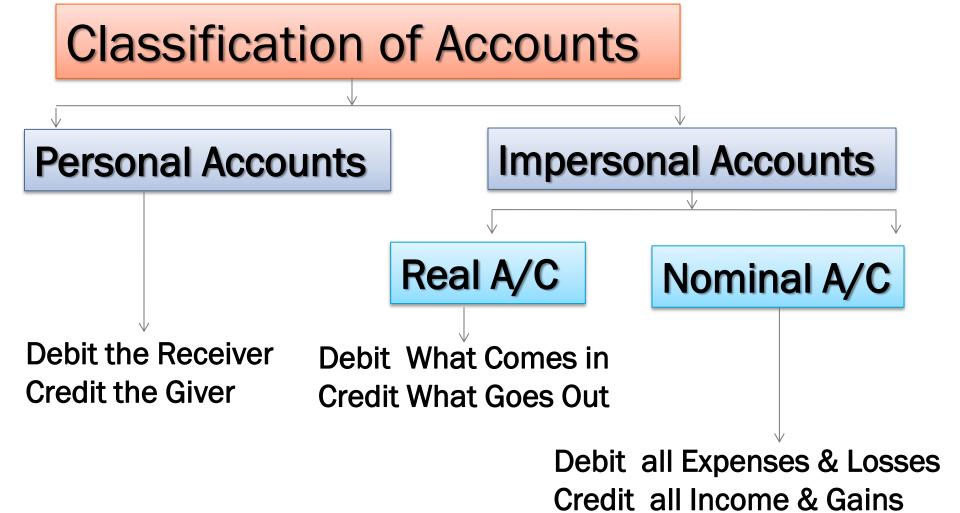
Accounting Conventions

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

GAAP Vs IFRS

Branches of Accounting

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



Self Check

- Land
- > Gopi
- > Cash
- > Furniture
- > Tele-Phone Bill
- > Tele-Phone

- > Goods
- > Salary
- Machinery
- > Stationary
- > Inventory

JOURNAL FORMAT

1	2	3	4	5
Date	Particulars	L.F	Dr Amount Rs	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	1,50,000	1,50,000
	(Being Capital Introduced)		
1	Motor Truck A/C Dr	50,000	
	To Cash		50,000
	(MT Purchased)		
2	Purchases A/C Dr	20,000	
	To Ahammed		20,000
	(Credit Purchases)		

Continued...

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

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

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

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/-		Ву	Moto r Truck	-	50,000/-
	" Sales	-	1,000/-		47	Purchases	-	5,000/-
	" Sales	-	800/-		47	Postal	-	5,000/-
					47	Advertising	-	500/-
					47	Office Expenses	-	40/-
					47	Drawing	-	1,000/-
					47	Premium	-	200/-
					47	Rent	-	1,000/-
					47	Salaries	-	5,000/-
					47	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 Chand Cash	1,000/- 2,500/- 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/- 19,500/-		By Purchase	20,000/-
	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 (-) Drawings (-) Net loss	1,50,000/- 1,000/- 27,090/-		Cash	89,010/-
		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 =
$$\frac{Long \ term \ Debt}{Share \ holders \ equities}$$

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

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

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

Coverage Ratios

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

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

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 =
$$\frac{\textit{Cost of goods sold}}{\textit{Average Inventory}}$$

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

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

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

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

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

C. Profitability Ratios

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

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

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

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

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

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=
$$\frac{EPS}{MPS}$$

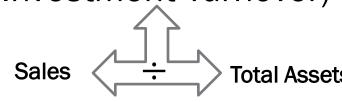
X. Dividend Yield=
$$\frac{DPS}{MPS}$$

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

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

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

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



Example:

Trading Account of SONY Ltd.

То	Opening Stock		2,00,000/-	Ву	Sales	26,00,000/-	
	Purchases	10,00,000/-			(-) Returns	1,00,000/-	
	(-) Returns	1,00,000/-					25,00,000/-
			9,00,000/-		Closing Stock		3,00,000/-
	Wages		3,00,000/-				
	Coal		2,00,000/-				
	Gross Profit		12,00,000/-				
			28,00,000/-				28,00,000/-

P & L Account for the Year

То	Salaries	2,00,000/-
	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/-

<u> </u>	Cai	
Ву	Gross Profit	12,00,000/-
		40.00.0007
		12,00,000/-

Balance Sheet of SONY Ltd. As on 31.12.2013

Capital + Liabilities

Assets

Equity Shares 10,000 @ 100 each	10,00,000/-	Fixed Assets	10,00,000/-
9% Preference Shares	5,00,000/-	Investment	5,00,000/-
Reserves	4,00,000/-	Good Will	4,00,000/-
Profit	5,00,000/-	Stock	3,00,000/-
10% Debentures	5,00,000/-	Debtor	5,00,000/-
Bank Over Draft	2,00,000/-	Bills Expenses	2,50,000/-
Creditors	2,50,000/-	Prepaid Expenses	1,00,000/-
Bills Receivables	1,75,000/-	Cash	2,00,000/-
O/S Expenses	2,25,000/-	Preliminary Expenses	5,00,000/-
	37,50,000/-		37,50,000/-

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

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

Cost Sheet

Particulars		Cost per Ton	Total Cost
Direct Materials : Opening Stock of Raw Material Add. Purchase of Raw Material	XXX XXX	Rs.	Rs.
	XXXX		
Less: Closing Stock of Raw Materials	XXX		
Cost of Material consumed		XX	XXX
Direct Labour		XX	XXX
Direct or Chargeable Expenses		XX	XXX
(a) Prime cost		XX	XXX
Works overhead or Factory overhead		XX	XX
(b) Works cost		XX	XXX
Office and Administration overhead		XX	XXX
(c) Cost of Production		VVV	
Selling and Distribution Overhead		XXX	XXX
(d) Cost of Sales		XX	XXX
Profit		XXX	XXXX
(e) Selling Price		XXX	XXX
		xxx	XXXX

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=
$$\frac{Fixed\ Cost}{P/V\ Ratio}$$
 or $\frac{Fixed\ Cost}{Unit\ Contribution}$

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.

SI. 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%

