

Intermediate Course
Study Material
(Modules 1 to 2)

Paper 8A

Financial Management

Module - 1



BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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BEFORE WE BEGIN....

The traditional role of a Chartered Accountant restricted to accounting and auditing, has now changed substantially and there has been a marked shift towards strategic decision making and entrepreneurial roles that add value beyond traditional financial reporting. The primary factors responsible for the change are the increasing business complexities on account of plethora of laws, borderless economies consequent to giant leap in e-commerce, emergence of new financial instruments, emphasis on corporate social responsibility, significant developments in information technology, to name a few. These factors necessitate an increase in the competence of Chartered Accountants to take up the role of not merely an accountant or auditor, but a global solution provider. Towards this end, the scheme of education and training is being continuously reviewed so that it is in sync with the requisites of the dynamic global business environment; the competence requirements are being continuously reviewed to enable aspiring chartered accountants to acquire the requisite professional competence to take on new roles.

Under the Revised Scheme of Education and Training, at the Intermediate Level, you are expected to not only acquire professional knowledge but also the ability to apply such knowledge in problem solving. The process of learning should also help you inculcate the requisite professional skills, i.e., the intellectual skills and communication skills, necessary for achieving the desired professional competence.

The entire syllabus has been divided into eleven chapters. The chapters have been grouped into two modules

Module-1 Consisting of Six chapters namely:

Chapter-1: Scope and Objectives of Financial Management

Chapter-2: Types of Financing

Chapter-3: Financial Analysis and Planning-Ratio Analysis

Chapter-4: Cost of Capital

Chapter-5: Financing Decisions-Capital Structure

Chapter-6: Financing Decisions-Leverages

Module-2 Consisting of five chapters namely:

Chapter-7: Investment Decisions

Chapter-8: Risk Analysis in Capital Budgeting

Chapter- 9: Lease Financing

Chapter- 10: Dividend Decisions

Chapter- 11: Management of Working Capital

The content for each chapter at the Intermediate level has been structured in the following manner –

1. Learning Outcomes – Learning outcomes which you need to demonstrate after learning each topic have been detailed in the first page of each chapter. Demonstration of these learning outcomes would help you to achieve the desired level of technical competence.

2. Chapter Overview - As the name suggests, this chart/table would give a broad framework of the contents covered in the chapter.

3. Introduction – A brief introduction is given at the beginning of each chapter, which would help you get a feel of the topic.

4. Content - In each chapter, the topics have been covered following ‘step by step’ approach. The concepts are explained in student-friendly manner with the aid of Examples/illustrations/diagrams/flow charts as per requirement. These value additions would help you develop conceptual clarity and to get a good grasp of the topic. Diagrams and Flow charts would help you understand the concepts in a better manner. Illustrations would help you understand the application of concepts/provisions.

5. Illustration with answers – Illustrations and examples have been included in the Study Material systematically, after discussion on each topic, so that application of the concept can be understood very clearly. This would also enable you to learn and sharpen your application skills and test your understanding.

6. Let us recapitulate – A summary of the chapter is given at the end to help you revise what you have learnt. It would especially help you to revise the chapter(s) quickly the day before the examination.

7. Test your Knowledge - This comprises of Multiple Choice Questions, Theoretical Questions and Practical Problems with solutions which test the breadth and depth of your understanding of the topic.

In this Study Material, formats of Financial Statements (i.e. Balance Sheet, Income Statements etc) and financial terms used are for illustrative purpose only. For appropriate format and applicability of various Standards, students are advised to refer the study material of appropriate subject (s).

Every effort has been made to make the Study Material error free, however if inadvertently any error is present and found by readers they may send it to us immediately, so that it can be rectified at our end.

In case you need any further clarification/ guidance, you may send your queries at sanjit.sharma@icai.in; and nnsengupta@icai.in.

Happy Reading and Best Wishes!

SYLLABUS

Objective:

To develop an understanding of various aspects of Financial Management and acquire the ability to apply such knowledge in decision-making.

1. Financial Management and Financial Analysis

(i) Introduction to Financial Management Function

- (a) Objective and scope of financial management
- (b) Role and purpose
- (c) Financial management environment
- (d) Functions of finance executives in an organization
- (e) Financial distress and insolvency.

(ii) Financial Analysis through Ratios

- (a) Users of the financial analysis
- (b) Sources of financial data for analysis
- (c) Calculation and Interpretation of ratios:
 - Analysing liquidity
 - Analysing leverage
 - Analysing solvency
 - Analysing efficiency/ activity
 - Analysing profitability
- (d) Limitations of ratio analysis

2. Financing Decisions

(i) Sources of Finance

- (a) Different Sources of Finance, Characteristics of different types of long term debt and equity finance, Method of raising long term finance
- (b) Different Sources of short term Finance
- (c) Internal fund as a source of finance
- (d) International sources of finance
- (e) Other sources of finance- Sale and lease back, Convertible debt, Venture capital, Grants etc.

(ii) Lease Financing

- (a) Concept and Classification
- (b) Significance and Limitations of Lease Financing
- (c) Financial Evaluation of Leasing Decision

(iii) Cost of Capital

- (a) Significance of cost of capital
- (b) Factors of cost of capital
- (c) Measurement of costs of individual components of capital
- (d) Weighted average cost of capital (WACC)
- (e) Marginal cost of capital
- (f) Effective Interest rate

(iv) Capital Structure Decisions

- (a) Significance of capital structure
- (b) Determinants of capital structure
- (c) Capital structure planning and designing
- (d) Designing of optimum capital structure
- (e) Theories of Capital Structure and value of the firm- relevancy and Irrelevancy of capital structure.
- (f) EBIT- EPS Analysis, Breakeven- EBIT Analysis.
- (g) Under/ Over Capitalisation.

(v) Leverages

- (a) Types of Leverages- Operating, Financial and Combined
- (b) Analysis of leverages

3. Capital Investment and Dividend Decisions

(i) Capital Investment Decisions

- (a) Objective of capital investment decisions
- (b) Methods of Investment appraisal:
 - Payback period, Discounted payback period
 - Accounting Rate of Return (ARR),
 - Net Present Value (NPV) - The meaning of NPV, Strengths and limitations of NPV method, The impact of taxation on the NPV analysis, The impact of Inflation on the NPV analysis, The working capital adjustment in an NPV analysis, Capital rationing, Equivalent Annual Costs, Adjusted present value
 - Internal Rate of return (IRR)- Limitations of the IRR method, Multiple IRRs,
 - Modified internal Rate of Return (MIRR)- Definition and explanation of MIRR, The process for calculating MIRR, Strengths of the MIRR approach.
 - Profitability Index

(ii) Adjustment of Risk and Uncertainty in Capital Budgeting Decision

- (a) Probability Analysis
- (b) Certainty Equivalent Method
- (c) Risk Adjusted Discount Rate
- (d) Monte Carlo Simulation
- (e) Decision Tree Analysis
- (f) Scenario Analysis
- (g) Sensitivity Analysis

(iii) Dividend Decisions

- (a) Basics of Dividends
- (b) Forms of dividend
- (c) Determinants of dividend
- (d) Relevancy and Irrelevancy of Dividend Policies- Traditional Approach, Walter's model, Gordon's model, Modigliani and Miller (MM) Hypothesis.

4. Management of Working Capital

(i) Management of Working Capital

- (a) The management of working capital- Liquidity and Profitability
 - (b) The Working capital financing decisions- Primary and Secondary Sources of Liquidity
 - (c) The working Capital Cycle (operating Cycle), Effectiveness of Working Capital based on its operating and cash conversion cycles
 - (d) Assessment of working capital requirement
 - (e) Management of Accounts Receivables (Debtors)
 - (f) Factoring and Forfaiting
 - (g) Management of Accounts Payables (Creditors)
 - (h) Management of Inventory
 - (i) Management of Cash, Treasury management
 - (j) Banking norms of working capital finance
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- Chapter-6 : Financing Decisions-Leverages

MODULE 2

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