INSURANCE EXAM · IC-89

IC-89 Management Accounting

Revision book

15	2	252
chapters	master tables	numbered sections

FREE SAMPLE: Chapter 1 of 15

CHAPTER 1

Introduction to Financial Management

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MUST KNOW

1. Financial management = planning and controlling financial resources to maximise returns.
2. **Functions:** acquisition of funds, raising of capital, allocation of funds among projects.
3. **Three decisions:** investment, financing, dividend.
4. **Ultimate objective:** wealth maximisation for shareholders.
5. Financial accounting = accrual; financial management = cash flow / fund flow.
6. Finance function = accounting and control + treasury management.
7. **Time value of money:** reasons are risk, present consumption, inflation, liquidity preference.

1.1 Basics

- **Two parts:** procurement of funds; allocation of funds.
- **PODSCORB:** Planning, Organising, Directing, Staffing, Co-ordinating, Controlling, Budgeting.
- Funds = short-term and long-term.
- **Procurement weighs:** sources, repayment terms, cost of capital, control (risk, cost, control).
- **Allocation:** funds must earn more than cost of capital; find idle or misused funds.
- **Skills for allocation:** capital budgeting, working capital, liquidity and solvency, investment analysis, portfolio management.

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"All of the above" is right for the functions list.

1.2 Equity vs debentures

Point	Equity	Debentures
Risk	Best (safest)	Interest due even in loss
Cost	Most expensive (entire divisible profit)	Cheaper (fixed interest, tax advantage)
Control	Undesirable	No control share
Tax	Dividend from taxed profit	Interest is an allowed expense

TRAP

Equity: safest but costliest.

1.3 Cross-border capital

- **Forms:** FDI, FII, ECB, ADR, GDR. FDI and FII = two major routes.
- Manager decides sources, finance mix, internal financing (retention vs payout).
- **Dated:** World Investment Report **2023**: India 8th largest FDI recipient in **2023**; 3rd in greenfield; 2nd in international project finance.
- **FDI holdbacks:** weather, developed-market uncertainty, geo-political issues, low p/e, falling ROI; high interest rates raise investor risk.

1.4 Scope

Traditional phase	Modern phase
Merger, amalgamation, takeovers	Size and growth rate
Acquisitions, expansions	Financing, capital structure, capital budgeting
Liquidation	Cost of capital, procurement
Internal capital structuring	Funds for better ROI
Financial statement analysis	Working capital, investment, dividend decisions

1.5 Objectives and role

- **Areas:** analysis and planning; capital structure and budgeting; cost of capital; funds management; working capital; investment; dividend; return and risk; merger, takeover, liquidation.
- Investment adds value only if present value of net cash inflows > initial outlay.
- **Five questions:** ROI, risk, cost of capital, risk-return trade-off, optimum fund to raise.
- **Manager needs:** financial accounting, macro and international economics, money and capital market skill.

1.6 FM vs financial accounting

Point	Accounting	Management
Work	Records, books, statements	Analysis, risk-return, capital budgeting
Basis	Accrual	Cash or fund flow
Deals with	Certainties, actuals	Uncertainties, probabilities

- **Primary disciplines:** accounting, marketing, production, quantitative and qualitative methods.
- **Statements:** Balance Sheet, Profit and Loss, Other Comprehensive Income, Cash Flow Statement.

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Fund flow principle is the basis of FM.

1.7 Three decisions

Decision	Key point
Investment	Decides how costly funds are allotted and committed; NPV, IRR; poor choice causes liquidity crunch, insolvency
Financing	Acquire optimum fund for fixed assets and working capital; sources: equity, preference, retained earnings, debentures, bank loans, bridge finance, venture capital, securitisation, lease
Dividend	When and how much to pay; DPS trend vs retention; profit vs wealth maximisation conflict

- Long-term projects = long-term funds; current assets = short-term funds.
- Financial analysis = mainly ratio analysis.

1.8 Time value of money

- Value of a rupee today differs from a rupee later. Preference for present money = time preference for money.
- **Study:** timing of flows; future value; present value; annuity future and present value; intra-year compounding and discounting.
- **Manager keeps updated:** risk measurement, cost of capital and ROI, risk-return, asset allocation, valuation of assets and derivatives, market efficiency, liquidity preference, external vs internal financing.

1.9 Financial system

- **Parts:** financial markets, instruments, regulatory framework.
- **Reforms:** NSE, depositories, custodians, SEBI, futures and options markets, forex market, rupee convertibility.
- **Instruments:** GDR, ADR, IDR, FCEB, FCCB, syndicated loans, venture capital.

1.10 Finance function

Treasury	Accounting and control
Financial planning analysis	Financial and management accounting
Fund acquisition	Budgeting and budgetary control
Investment decisions	External reporting
Fund allocation, investment financing	Tax planning and management
Cash management	MIS and internal control
Financial risk management	

- Acquisition and allocation of funds = core of treasury; aim is optimum risk and return.

> **TRAP**
> Tax planning, budgetary control, external reporting = control, not treasury.