



# **FINANCE FOR NON-FINANCIAL MANAGERS**

By Dr. Rajashree Yalgi

Welcome

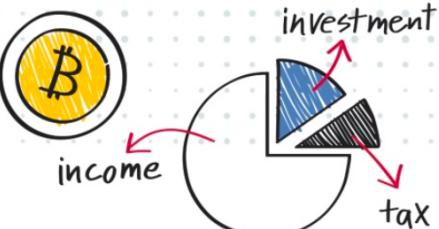
Session 1: Finance for non-financial managers



## Episode 1



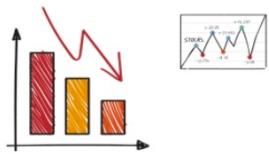
## Episode 2



# FINANCE



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## Episode 4



Financial Plan



## Episode 3



## Fundamentals of accounting

Language  
of  
business

Interpret  
&  
Analyze

Record  
&  
Summarize

## Definition

- Recording
- Classifying
- Summarising
- Money
- Transactions
- Events
- Financial Character

## Objectives of accounting



# Users of accounting



## Important terms

Debit/credit

Transaction

Balance sheet

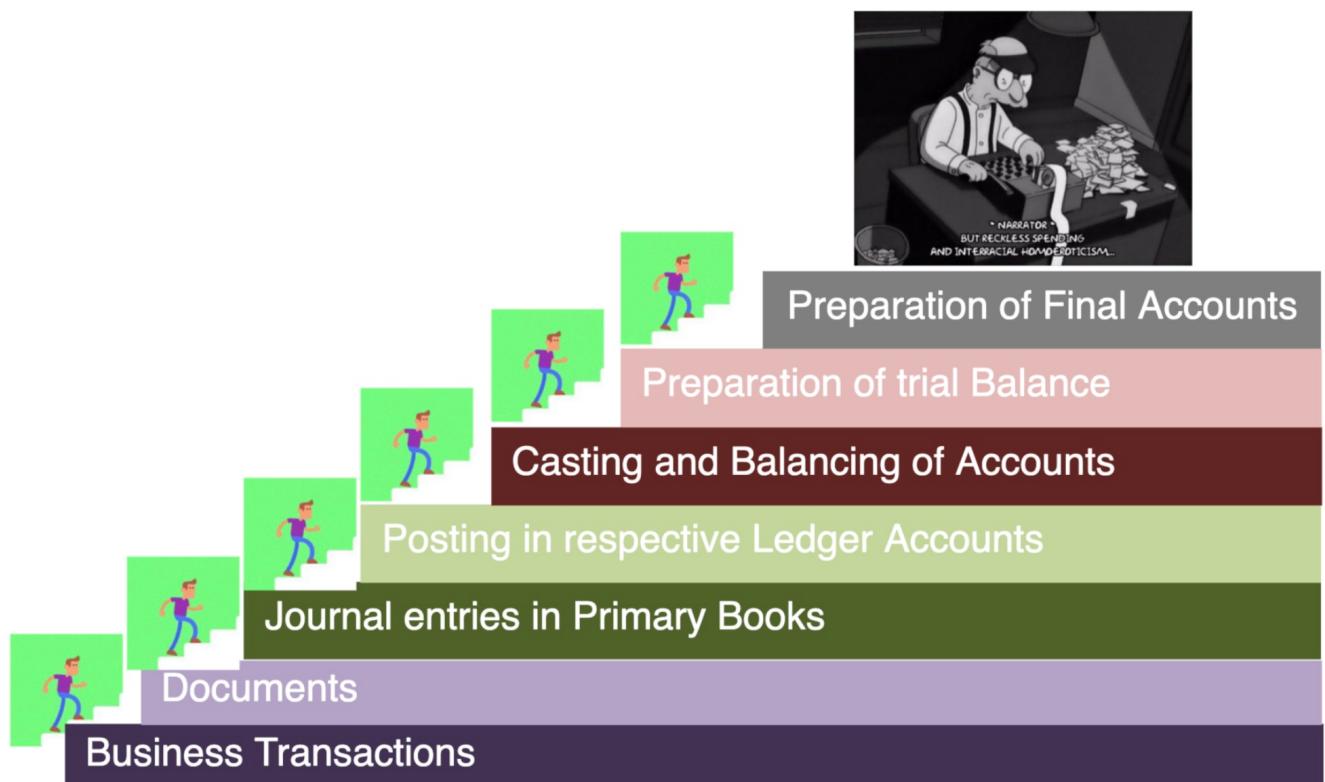
Capital

Assets

Bad debt

Depreciation

Working capital



# Generally Accepted Accounting Principles



## **Accounting Conventions**

- Conservatism
- Consistency
- Materiality
- Disclosure
- Objective Evidence

## **Financial Management**

- Efficient Capital
- Study of problems
- Acquisition

# Finance Management

- Specialized function
- Maximise wealth
- Profitable investment
- **"The success of any enterprise depends on strategic choices made and how funds are employed."**

## Finance Managers

- Accounting professional
- Financial well-being
- Advise
- Company assets



**Finance Manager** - a professional person, with sufficient knowledge of economic & accounting systems to enable to assist owners in achieving main goal.

### **Financing**

- Financial Report: Statement of Financial Position
- Owner's Equity and Liabilities

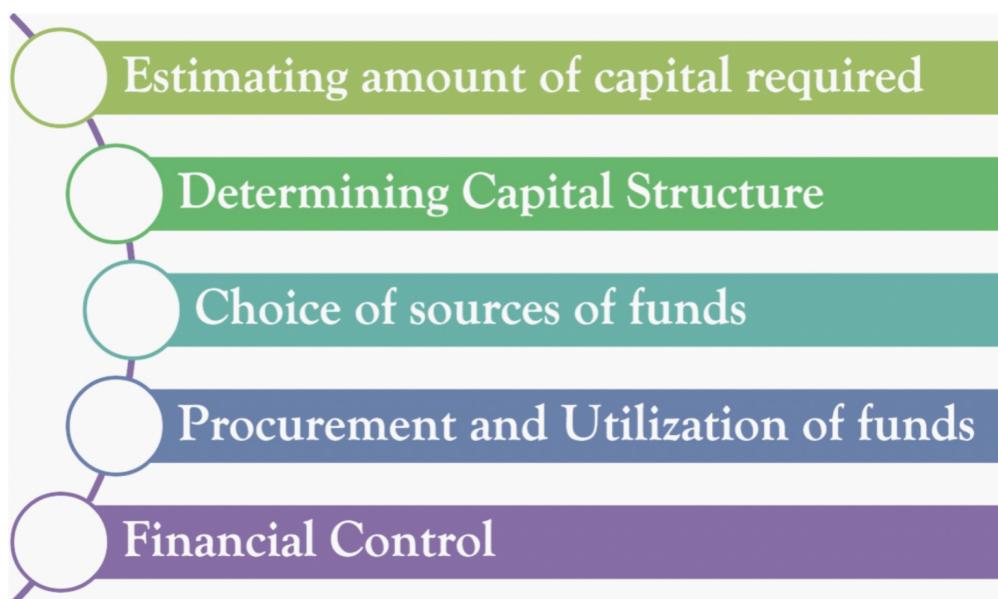
### **Operating**

- Financial Report: Statement of Comprehensive Income
- Profit or Loss

### **Investing**

- Financial Report : Statement of Financial Position
- Assets

## Functions of a finance manager



# **Accounting**

**vs.**

# **Finance**

	Accounting	Finance
Clients	Individuals, businesses, governments	Individuals, businesses, governments
Main Employers	Public accounting firms, corporations	Banks, corporations
Financial Statements	Responsible for preparing them	Responsible for analysing them
View Point	Backward looking	Forward looking
Focus	Accuracy, reliability	Insights, analysis
Business Purpose	Communicating the financial position	Figuring out how to add value
Thought Process	Rules based	Analysis based

## Financial planning process



**Short term planning**

**Long term planning**

## **Analysing financial statements**

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- Provide information
- Past and present performance

- Aid in analysis
- Effective decision making

## Select

- Purpose of analysis
- Who is it for?
- Appropriate tools and resources to utilise

## Compare

- Other companies
- Previous periods and years
- The industry and economy
- Budgets and targets
- Short and long term plans

## Evaluate

- Is it good or bad?
- Was the result expected
- If bad, why?
- If good, can it be maintained?
- Who or what is responsible by when?

## Predict

- What is likely to happen if action is not taken
- What improving actions are possible?

# Financial statement analysis

## Part 1

## Part 2

Comparative analysis

Index analysis

Common-size analysis

Ratio analysis

## What is a comparative analysis

Involves comparing changes in financial statements from year to year. Most importantly, they disclose trends.

Statements of the financial position of a business to facilitate comparison of different accounting variables for interpreting.

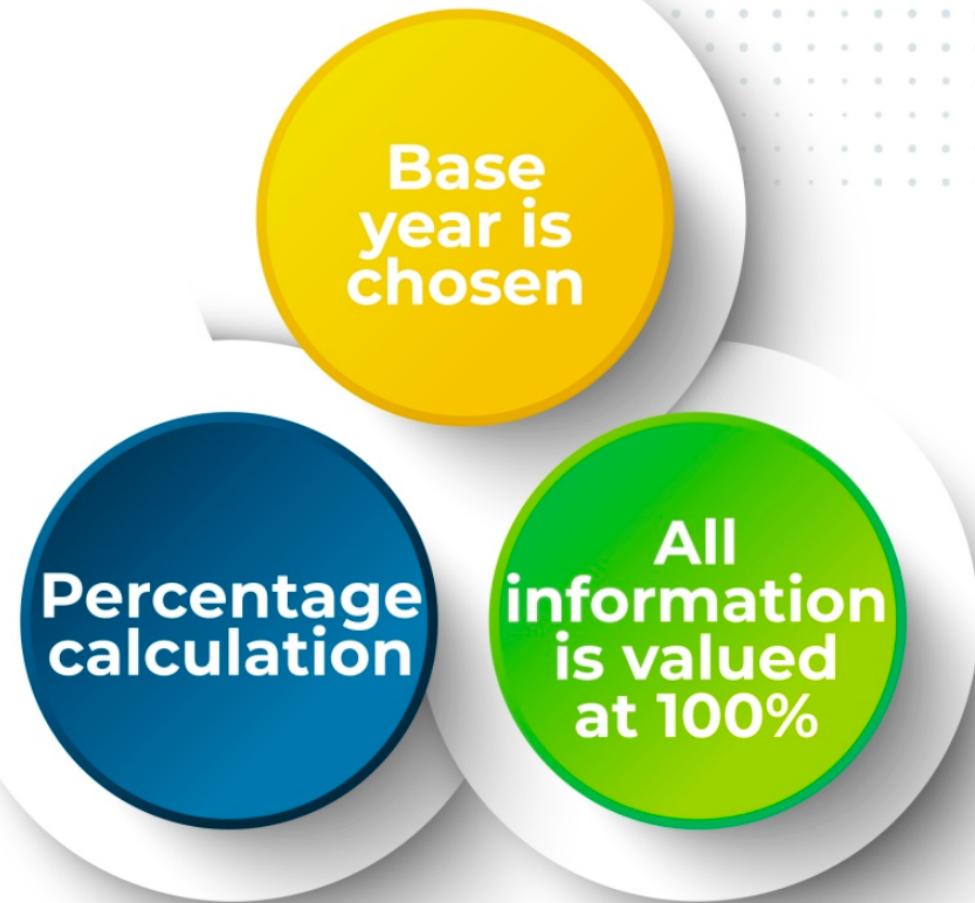
Financial Statements of more business enterprises compared & is known as 'Inter-firm comparison'.

<b>Advantages</b>	<b>Disadvantages</b>
<ul style="list-style-type: none"><li>- Indicate movement</li><li>- Suitable for comparison</li><li>- Review past activity</li><li>- Cumulative effect</li><li>- Displays nature and trends</li></ul>	<ul style="list-style-type: none"><li>- Lose significance</li><li>- Constant change in price</li><li>- Pointless comparison</li><li>- Cumulative effect</li><li>- 2 Incompatible periods being compared</li></ul>

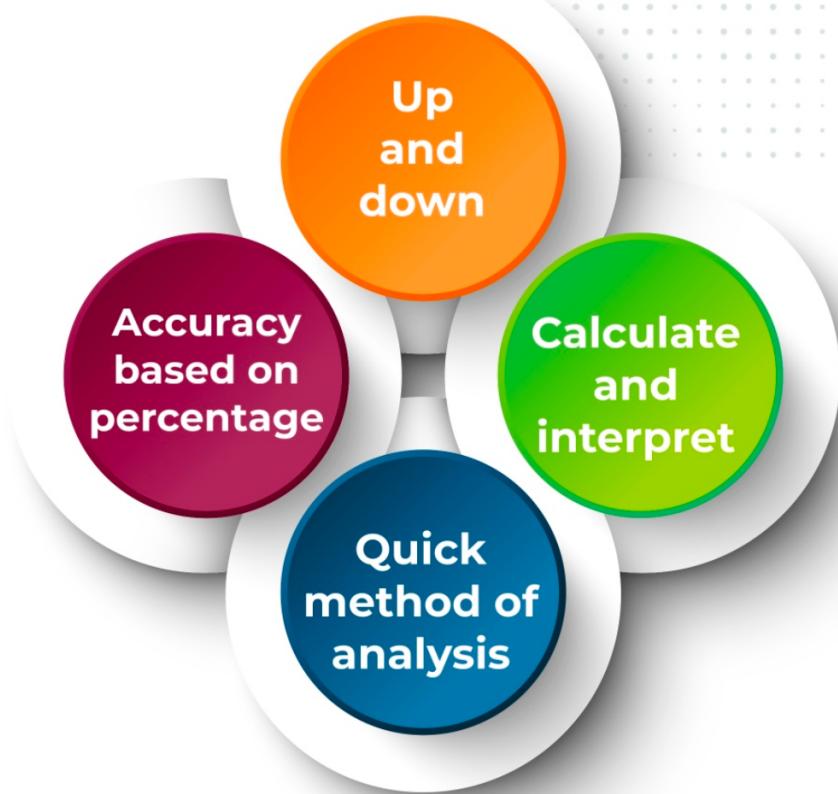
Particulars	2016 (Amount in USD)	2017 (Amount in USD)	Absolute Change	Percentage Change
Net Sales	200000	250000	50000	25%
Less: Cost of Goods Sold	150000	180000	30000	20%
Gross Profit	50000	70000	20000	40%
Less: Selling, General and Administrative Expenses	25000	30000	5000	20%
Net Operating Profit	25000	40000	15000	60%
Add: Other Income	12000	18000	6000	50%
Earnings before Interest and Taxes	37000	58000	21000	56.76%
Less: Interest	17000	18000	1000	5.88%
Earnings before Taxes	20000	40000	20000	100%
Less: Taxes	8000	16000	8000	100%
Net Profit	12000	24000	12000	100%

# What is an index analysis

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# Usage of index analysis



	2012		2010 Base
Turnover	154%		100%
Cost of sales	169%		100%
Gross profit	138%		100%
Marketing and distribution costs	172%		100%
Administration expenses	173%		100%
Other operating costs	184%		100%
Earnings before interest and taxation	77%		100%
Interest payable	175%		100%
Earnings after interest and before taxation	54%		100%
Taxation	53%		100%
Earnings after taxation	54%		100%
Dividends	54%		100%
Retained earnings for the year	54%		100%
Retained earnings at the beginning of the year	168%		100%
Retained earnings at the end of the year	122%		100%

# Common size statements

01

Financial statements converted to percentages  
Common base

03

Other items expressed as percentages of sales

02

Net sales assumed to be 100%

04

Liabilities assumed to be 100%

05

Other items of assets and liabilities are expressed as  $\pm 100\%$

06

Component statements / 100% statements

07

Each statement reduced to 100%  
Individual item are expressed as a percentage of this total

## Advantages of common size statements

Reveals source of **capital** and **other sources**

Distribution of total funds

Indicates changes in assets, liabilities, costs, net sales and profit proportions

Assist corporate evaluation and ranking

## Limitations of common size statements

No variations in comparative CSS depicted

No established standard proportion of assets

Lack of consistency

Absence of third dimensional consistency

# What is Ratio Analysis?

Infinite number of ratios

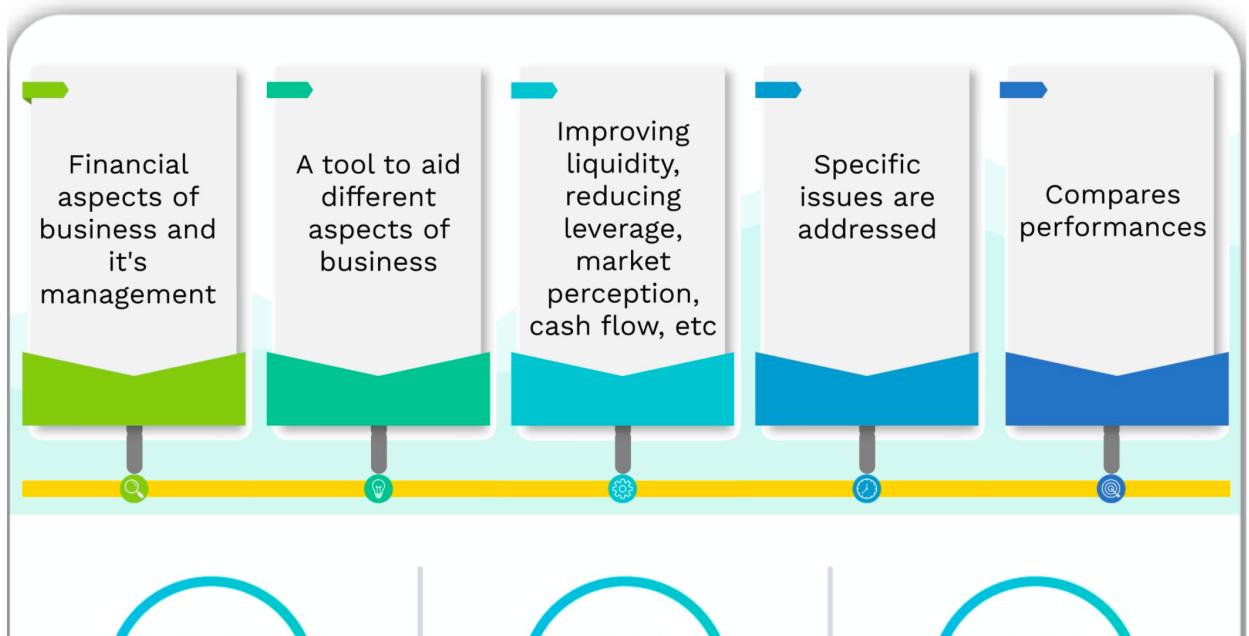
For meaningful analysis of company results...

Relationship between 2 variables

Clear

Direct

Understandable



$$\text{Gross Profit Margin} = \frac{\text{Gross Profits (in figures)}}{\text{Revenue (in figures)}} \times 100$$

• Gross profit  
• Sales - Cost of Goods Sold

• Revenue  
• Sales - Sales Returns

# Ratio Analysis categories

Uniform accounting terms as per International Accounting Standards in all countries

29.472

## Old Terms

- Sales
- Fixed Asset
- Long-term liability
- Stock
- Debtors
- Creditors

## New Terms

- Revenue
- Non-current assets
- Non-current liabilities
- Inventory
- Trade receivables
- Trade payables

38.552

31.346

30.255



Profit margins → Profitability → Turnover → Turnover time

Liquidity

Solvency

Investment/  
Market value

Cash flow



# The Zulu Love Bean (Pty)Ltd

Statement of comprehensive income for the year ending 31 December 2014

	31 December 2014	31 December 2013
	ZAR	ZAR
Revenue	390 000	355 000
Cost of sales	(250 00)	(200 000)
Gross profit	140 000	155 000
Other income	9 000	8 700
Distribution costs	(20 000)	(21 000)
Administrative expenses	(2 100)	(1 200)
Other expenses	(8 000)	(7 500)
Finance costs	(15 000)	(15 100)
Profit before tax	103 900	118 900
Income tax expense	(29 092)	(33 292)
<b>Profit After Tax (PAT/ Net Income)</b>	<b>74 808</b>	<b>85 608</b>

## Zulu Coffee Bean Pty Ltd.

Statement of Financial Position as at 31 December 2014

	31 DEC 2014	31 DEC 2013
	ZAR	ZAR
<b>ASSETS</b>		
Non-current Assets		
Property Pland & Equipment	10,30,000	10,40,000
	10,30,000	10,40,000
Current Assets		
Inventories	1,000	1,000
Trade Receivables	5,400	8,540
Other Current Assets	500	200
Cash & Cash Equivalents	50,000	1,50,000
	56,900	1,59,740
<b>Total Assets</b>	<b>10,86,900</b>	<b>11,99,740</b>
<b>EQUITY &amp; LIABLIITIES</b>		
Equity attributable to owners of parent company		
Share Capital	100	100
Retained Earnings	3,60,416	2,85,608
	3,60,416	2,85,608
Non-current Liabilities		
Long-term borrowings	7,11,628	9,00,032
	711628	900032
Current Liabilities		
Trade & Other Payables	8,256	9,000
Current tax payable	6,500	5,000
Total Current Liabilities	14,756	14,000
Total Liabilities	7,26,384	9,14,032
<b>Total Equity &amp; Liabilities</b>	<b>10,86,800</b>	<b>11,99,640</b>

## Formula

$$\text{EBIT Margin} = \frac{\text{Profits Before Interest and Taxes (in figures)}}{\text{Sales (in figures)}} \times 100$$

## Example

$$\text{EBIT Margin} = \frac{118,900}{390,000} \times 100$$

## Formula

$$\text{Gross Profit Margin} = \frac{\text{Gross Profit (in figures)}}{\text{Sales (in figures)}} \times 100$$

## Example

$$\text{Gross Profit Margin} = \frac{140,000}{390,000} \times 100 = 36\%$$

35

60

38

# Formula

$$\text{Net Profit Margin} = \frac{\text{Net Profits (in figures)}}{\text{Sales (in figures)}} \times 100$$

## Example

$$\text{Net Profit Margin} = \frac{74,808}{390,000} \times 100 = 19\%$$

# Formula

$$\text{Return on Assets} = \frac{\text{Profits after Tax (in figures)}}{\text{Total Assets (in figures)}} \times 100$$

## Example

$$\text{Return on Assets} = \frac{74,808}{1086900} \times 100 = 6,9\%$$

# Formula

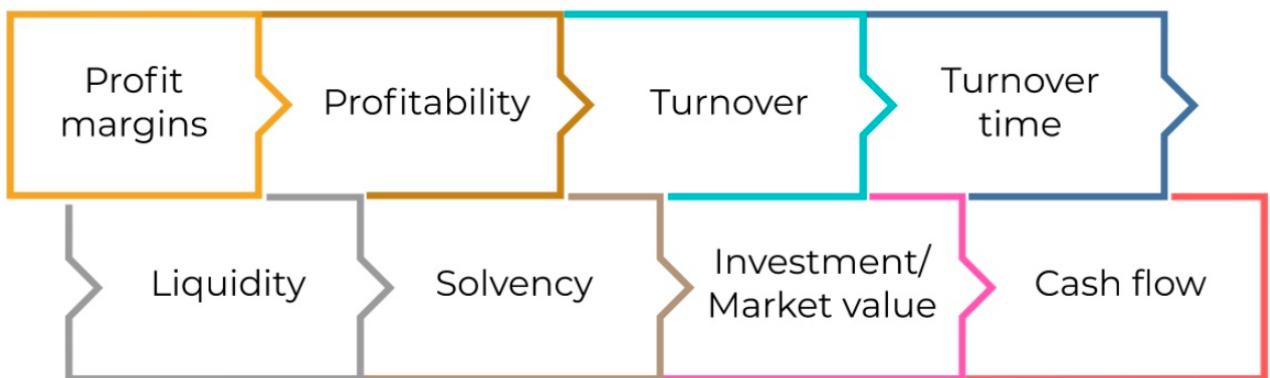
$$\text{Return on Equity} = \frac{\text{Profits after Tax (in figures)}}{\text{Total Shareholder's Funds (in figures)}} \times 100$$

## Example

$$\text{Return on Equity} = \frac{74,808}{360516} \times 100 = 20.75\%$$



# RATIO ANALYSIS CATEGORIES



# Financial Statements

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# Turn-over Ratios

Total Asset Turnover

Current Asset Turnover

Property, Plant & Equipment Turnover

Trade Receivable Turnover

Trade Payable Turnover

Inventory Turnover

## Total Asset Turnover

$$\text{Total Asset Turnover} = \frac{\text{Sales (in figures)}}{\text{Total Assets (in figures)}} \times 100$$

$$\text{Total Asset Turnover} = \frac{390,000}{1,086,900} \times 100 = 0.36 \text{ times}$$

## Current Asset Turnover

$$\text{Current Asset Turnover} = \frac{\text{Sales (in figures)}}{\text{Current Assets (in figures)}} \times 100$$

$$\text{Current Asset Turnover} = \frac{390,000}{56,900} \times 100 = 6.85 \text{ times}$$

## Property, Plant & Equipment Turnover

$$\text{PPE Turnover} = \frac{\text{Sales (in figures)}}{\text{PPE Carrying Value}} \times 100$$

$$\text{PPE Turnover} = \frac{390,000}{1,030,000} \times 100 = 0.38 \text{ times}$$

## **Trade Receivable Turnover**

$$\text{Trade Receivable Turnover} = \frac{\text{Sales (in figures)}}{\text{Trade Receivable (in figures)}} \times 100$$

$$\text{Trade Receivable Turnover} = \frac{390,000}{5,400} \times 100 = 72.22 \text{ times}$$

## **Trade Payable Turnover**

$$\text{Trade Payable Turnover} = \frac{\text{Cost of Sales (in figures)}}{\text{Trade Payables (in figures)}} \times 100$$

$$\text{Trade Payable Turnover} = \frac{250,000}{8,256} \times 100 = 30.28 \text{ times}$$

# Inventory Turnover

$$\text{Inventory Turnover} = \frac{\text{Cost of Sales (in figures)}}{\text{Inventory (in figures)}} \times 100$$

$$\text{Inventory Turnover} = \frac{250,000}{1,000} \times 100 = 250 \text{ times}$$

## Turn-over Ratios

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## **Trade Receivable Turnover Time**

$$\text{Trade Receivable Turnover} = \frac{\text{Sales (in figures)}}{\text{Trade Receivable (in figures)}} \times 100$$

$$\text{Trade Receivable Turnover} = \frac{390,000}{5,400} \times 100 = 72.22 \text{ times}$$

## Inventory Turnover Time

$$\text{Inventory Turnover Time} = \frac{\text{Inventory}}{\text{Cost of Sales}} \times \frac{365}{1}$$

$$\text{Inventory Turnover Time} = \frac{1,000}{250,000} \times \frac{365}{1} = 1.46 \text{ days}$$

## Trade Payable Turnover Time

$$\text{Trade Payable Turnover} = \frac{\text{Cost of Sales (in figures)}}{\text{Trade Payables (in figures)}} \times 100$$

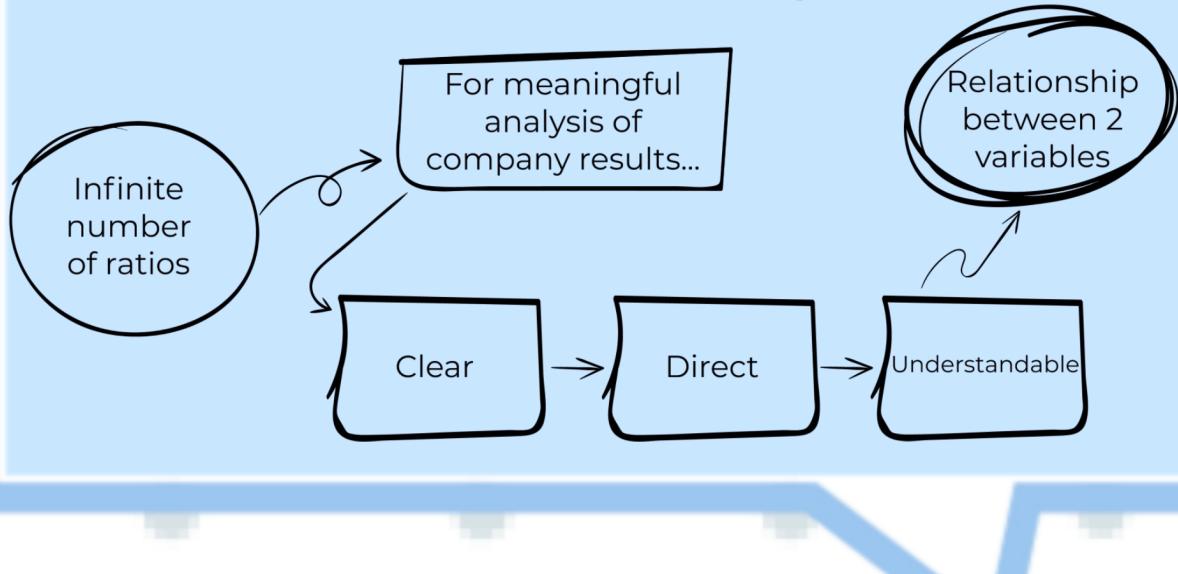
$$\text{Trade Payable Turnover} = \frac{250,000}{8,256} \times 100 = 30.28 \text{ times}$$

## Cash Conversion Cycle

$$\text{CCY} = \text{TR Turnover Time} + \text{Inventory Turnover Time} - \text{TP Turnover Time}$$

$$\text{Cash Conversion Cycle} = 5 + 1.46 - 12 \text{ (days)} = -5.54 \text{ days}$$

## What is Ratio Analysis?



## Current Ratio

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\text{Current Ratio} = \frac{59,000}{14,756} = 3.86 : 1$$

# Quick Ratio

Quick Ratio =  $\frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}$

$$\text{Quick Ratio} = \frac{56,900 - 1000}{14,756} = 3.86 : 1$$

# Cash Ratio

Cash Ratio =  $\frac{\text{Cash (Cash equivalents)}}{\text{Current Liabilities}}$

$$\text{Cash Ratio} = \frac{50,000}{14,756} = 3.39 : 1$$

# Solvency

## Debt-Asset Ratio

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

$$\text{Debt to Asset} = \frac{726,384}{1086,900} = 67\%$$

## Debt-Equity Ratio

$$\text{Debt to Equity} = \frac{\text{Long term + Short term (Borrowings)}}{\text{Total Equity}}$$

$$\text{Debt to Equity} = \frac{711,628}{360,516} = 1.97 \text{ (Debt is almost twice that of equity)}$$

## Interest Coverage Ratio

$$\text{Interest Coverage Ratio} = \frac{\text{EBIT}}{\text{Finance Cost}}$$

$$\text{Interest Coverage Ratio} = \frac{1,18,900}{15,000} = 8 \text{ times}$$

## Financial Leverage Ratio

$$\text{Financial Leverage} = \frac{\text{Total Assets}}{\text{Total Equity}}$$

$$\text{Financial Leverage} = \frac{1086,900}{360,516} = 3.014 \text{ (3 times)}$$

# Debt-Asset Ratio

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$$\text{Debt to Asset} = \frac{726,384}{1086,900} = 67\%$$

# **Debt-Equity Ratio**

Debt to Equity =  $\frac{\text{Long term + Short term (Borrowings)}}{\text{Total Equity}}$

Debt to Equity =  $\frac{711,628}{360,516} = 1.97$  (Debt is almost twice  
that of equity)

# **Financial Leverage Ratio**

Financial Leverage =  $\frac{\text{Total Assets}}{\text{Total Equity}}$

Financial Leverage =  $\frac{1086,900}{360,516} = 3.014$  (3 times)

# **Interest Coverage Ratio**

Interest Coverage Ratio =  $\frac{\text{EBIT}}{\text{Finance Cost}}$

Interest Coverage Ratio =  $\frac{1,18,900}{15,000} = 8$  times



Ratios are based on Anglo American Plc Data;  
Per S.African convention

## Earnings Per Share

$$\text{Earnings Per Share} = \frac{\text{Headline Earnings(S. Af)}}{\text{Total Number of Ordinary Shares (Basic)}}$$

$$\text{Earnings Per Share} = \frac{3056,000,000}{1239,000,000 \text{ (Basic)}} = \$ 2.47 \text{ (Basic)}$$

An ordinary share represents equity ownership, entitling its owner to vote in matters put to shareholders; without predetermined dividends; for EPS from PAT the dividends for Preference shareholders have to be removed and that is the residual income to ordinary voting-right enabled shares; some other adjustments too are considered apart from dividends to preference shares;

# Dividends Per Share

$$\text{Dividends Per Share} = \frac{\text{Ordinary Dividends}}{\text{Number of Ordinary Shares}}$$

$$\text{Dividends Per Share} = \frac{900,000,000}{1239,000,000 \text{ (Basic)}} = \$ 0.726 \text{ cents p/s}$$

This amount of dividends ordinary shareholders with voting rights received from the firm. Dividends are declared as a percentage or part of the face-value of the ordinary shares of the firm; dividends are recorded in the income statement only after its approval by the dividend eligible ordinary voting shareholders

# Price to Earnings Multiple Value

$$\text{Price to Earnings Multiple} = \frac{\text{Market Price Per Ordinary Share}}{\text{Earnings per Ordinary Share}}$$

$$\text{Price to Earnings Multiple} = \frac{\$ *33.13}{\$ 2.53} = \$ * 13.09$$

What investors are prepared to pay for \$ 1 of EPS earned by the company. Market's expectation of the Firms ability to generate earnings; Asterisk mark in this case shares quoted in GBP, was converted to US Dollars

# Dividend Payout Ratio

$$\text{Dividend Payout Ratio} = \frac{\text{Ordinary Dividends Paid (or Declared)}}{\text{Net Earnings}}$$

$$\text{Dividends Payout Ratio} = \frac{899,000,000}{2089,000,000} = \$ 0.43\text{cents p/s}$$

It is the percentage of the net income which is paid to investors as their share of profits – dividend; paid only to shareholders holding ordinary shares with voting rights; it does not concern itself with preference dividend paid to preference shareholders

# Market to Book Value

$$\text{Market to Book Value} = \frac{\text{Market Capitalization of Ordinary Shares}}{\text{Book Value of Ordinary Shares}}$$

$$\text{Market to Book Value} = \frac{42 (\text{Bn})}{25.82 (\text{Bn})} = \$ 1.63$$

It is how much the market has valued the equity vis-à-vis for its book value of equity; If the market value is high, it means the market has perceived the value of the firm's shares to be relatively higher than its book value which is its intrinsic value

# Cash Flow to Debt Ratio

$$\text{Cash Flow to Debt} = \frac{\text{Operating Cash Flow}}{\text{Total Debt}}$$

$$\text{Cash Flow to Debt} = \frac{6.618}{12.317} = 0.54$$

"Researchers have constantly found that the cash flow to total debt ratio is a reliable indicator of financial distress." (Correia et al, 2007:19)

# Cash Flow Turnover Ratio

$$\text{Cash Flow Turnover} = \frac{\text{Operating Cash Flow}}{\text{Sales}}$$

$$\text{Cash Flow Turnover} = \frac{6618}{30902} = 0.21$$

Indicates the portion of the company's turnover that is converted to cash flow and its ability to convert the sales quickly to cash; this is indicative of how quickly the credit sales is collected or the efficiency with which the collections of trade receivables happen

# Cash Flow to Operating Profit Ratio

$$\text{Cash Flow to Operating Profit Ratio} = \frac{\text{Operating Cash Flow}}{\text{Operating Profit}}$$

$$\text{Dividends Cover Ratio} = \frac{6618}{6687} = 0.99$$

Shows the portion of profits that is eventually converted to cash flow

## Dividend Cover Ratio

$$\text{Dividends Cover Ratio} = \frac{\text{Operating Cash Flow} + \text{Dividends Paid}}{\text{Dividends Paid}}$$

$$\text{Dividends Cover Ratio} = \frac{6618+899}{899} = \$ 8.36$$

Dividend coverage ratio is suggestive of the quantum of cash-flow from operations and its adequacy to pay-off the dividends declared; it checks whether the operations are generating cash to pay off any dividends to the ordinary shareholders

# Limitations:

“While ratio analysis is obviously a very useful technique for evaluating performance, there are some limitations that need to be considered before it is applied mechanically. Applying ratio analysis blindly, using a procedural approach, is dangerous as the effectiveness of the exercise depends upon the interpretation of the ratios by the analyst.” - (Correia *et al*, 2007:24-25)

**Diversified industries:** When comparing the ratios to another company, one should not compare **Zulu Love Bean** coffee shop business to a different business in a different industry, for example a bank or a construction company;

**Inter-firm comparisons and different accounting policies:** Even though the use of IFRS assists in standardising accounting policies across different companies, companies can still to some extent tailor policies to best suit their businesses.

# What is budgeting?

Manager to make decisions to maximise wealth of shareholders;

Manager make best use of **limited resources** available to create shareholders wealth;

Budgeting → process of allocating **scarce resources** to prioritised needs of organisation;

It gives **direction** to business → in terms of revenue and expenditure planning;

Help firms program **growth** based on realistic assumptions;

Budgets can go wrong if **assumptions unrealistically & misaligned with market**

## Key characteristics

Important for the planning process;

Essential for decision-making;

Restricts, controls, and evaluates the use of scarce resources;

Evaluates financial performance by comparing budget to actual results; and

Prioritises activities.

# Budgeting - The how

## Top-down:

- Top Management Sets Budget: Sales, Expenses and Profit numbers;
- Passed down to team members;
- Lower rung team works to achieve those budgeted numbers

## Bottom-up:

- Front-line staff gathers market insights and inputs
- Provided to top executive by front-line staff
- Top management prepares overall budget: sales, expenses & profits based on those inputs

# The approach defined

**Incremental budgeting** considers last year's budget and makes incremental adjustments to the new budget (ACCA, 2014).

**Programme budgeting** is planning and allocating resources in order of priority (Weetman, 2013:591).

**Activity-based budgeting:** "...activities that incur costs in every functional area of an organization are recorded and their relationships are defined and analysed. Activities are then tied to strategic goals; the costs of those activities are then used to create the budget" (Investopedia, 2014d).

**Zero-based budgeting:** "...expenses must be justified for each new period. Starts from a 'zero base' and every function in a firm analysed for its needs & costs. Budgets built around the needs for upcoming period, regardless of higher or lower budget in previous year"

# Cost Implications

Budgeting as much of revenue as it is of costs;

Costs are two classes:

**Fixed Costs:** remain static throughout a period, change less occasionally; not linked with production of goods / services; usually factory / operating overheads;

**Variable Costs:** are dynamic; change more frequently; directly linked to production of goods / services; direct costs; increase with increased production and vice versa

**Examples of Fixed Cost:** rental on buildings or factory premises (static for a certain period of time); salaries of permanent employees; administrative overheads;

**Examples of Variable Cost:** For a steel plant it is direct labour; raw materials: iron-ore; cost of machinery and equipment to produce steel

## Different types of budget

**Sales Budget:** Direction of sales or revenue; gives a direction to the overall budget;

- Prepared based on estimates of revenue or sales; use of forecasting methods must; includes marketing expenses
- Usually it is periodical: monthly or quarterly;

**Production or Operation Budget:** takes cues from sales;

- Determines the expenditures based on sales numbers;

# What is Variance analysis

Process of identifying differences from budgeted;

Investigating the reasons for these differences, and;

Determining whether expectations should be re-evaluated;

**Variance & significance:**  
Depending on the manager this could be assessed to be either significant or insignificant;

**Actions warranted:** only where the difference or its magnitude is significant that it calls for actions of: re-evaluation or re-estimation;

## **Variance analysis - The steps**

1. Compare actual costs to budgeted costs

2. Calculate variances

3. Identify important variances

4. Investigate the reasons for the variances

5. Make conclusions about the variances

6. Take corrective action

# Variance analysis - example

Budget for The Zulu Love Bean (Pty) Ltd for January 2014

Expenses	Budget	Actual	Variance
Electricity	100	80	20
Stationery	50	55	-5
Printing	80	80	0

Finance manager of ZLB set a budget for January 2014. A section of the budget is shown above;

The variance analysis | Compare actual costs to budgeted costs:

Electricity was budgeted at R100, but the actual cost of electricity was R80.

Stationery was budgeted at R50, but the actual cost of stationery was R55.

Printing was budgeted at R80, but the actual cost of printing was R80.

# Variance analysis - example

Budget for The Zulu Love Bean (Pty) Ltd for January 2014

Expenses	Budget	Actual	Variance
Electricity	100	80	20
Stationery	50	55	-5
Printing	80	80	0

Finance manager of ZLB set a budget for January 2014. A section of the budget is shown above;

Calculate the variances:

Electricity was overbudgeted at R20 more than was actually spent;

Stationery expense was under budget by R5. Printing was as budgeted.

# Variance analysis - example

Identify important variances:

Electricity was over budget by R20 or 20% (20/100), which the manager considers material;

**Investigate variances:** Owing to power outages (“load shedding” by Eskom), ZLB’s electricity bill was not as high as expected.

**Conclusions on variances:** Even though there were power outages that resulted in the reduced electricity expense, ZLB’s manager expects Eskom to increase the tariffs in the near future.

**Corrective actions:** No adjustments are needed to the budget for January 2014.

# Spelling the need

**Importance:** in order to ensure that a company has enough cash to settle its debt as it becomes due;

A business with liquidity issues cannot sustain its operations;

A cash flow budget or cash flow forecast, is generally used for effective cash planning;

Financial statements include multiple adjustments and cannot be used for effective cash planning;

Depreciation is one such adjustments which is a non-cash expense;

## Cash budget format

	Jan.	Feb.	...	Nov.	Dec.
Total cash receipts	R. 10,000	R. 15,000		R. 16000	R. 12000
Less: Total cash disbursements	R. 5500	R. 4500	-	R. 4300	R. 3500
Net cash flow	R 4500	R. 10,500		R.11,700	R. 8500
Add: Beginning cash	R. 4000	R. 3000	R. 2500	R. 5000	R. 4000
Ending cash	R. 8500	R. 13,500	R. 2500	R. 16,700	R 12,500
Less: Minimum cash balance	R. 2500	R. 3000	...	R. 2000	R. 1000
Required total financing		R 2000		R. 3000	nil
Excess cash balance	R. 6000	R.12,500	R. 2500	R. 17,700	R. 11,500

# Cash budget - exercise

Prepare a proforma Cash Budget for Skyhigh Services from the following information;

Accounting year: Jan – Dec; | Skyhigh services is providing ground support operations to SA Airways;

Opening cash balance R. 3500

Sales: Q1. R 450, Q2. 550, Q3. 600, Q4. 400

Cash Expenses: 25% of sales; 30% in Q1, 25% in Q2, 20% in Q3 balance in Q4;

Bank borrowing: Q2. R 300, Q4. R 450;

What will be the cash balance in Q4 for Skyhigh Services?

## Cash budget format

	Jan.	Feb.	...	Nov.	Dec.
Total cash receipts	R. 10,000	R. 15,000		R. 16000	R. 12000
Less: Total cash disbursements	R. 5500	R. 4500	~	R. 4300	R. 3500
Net cash flow	R 4500	R. 10,500		R.11,700	R. 8500
Add: Beginning cash	R. 4000	R. 3000	R. 2500	R. 5000	R. 4000
Ending cash	R. 8500	R. 13,500	R. 2500	R. 16,700	R 12,500
Less: Minimum cash balance	R. 2500	R. 3000	...	R. 2000	R. 1000
Required total financing		R 2000		R. 3000	nil
Excess cash balance	R. 6000	R.12,500	R. 2500	R. 17,700	R. 11,500

# Production budget problem

Farm-Tech Tools has the following information for second half of six 2018 for one of their equipment gear system;

Sales month-wise

July'18 = 2,100 | Aug'18 = 2,100 | Sep'18 = 3,300 | Oct'18 = 3,700 | Nov'18 = 4,800 | Dec'18 = 4,700 | Jan'19 = 4,200;

Work in progress information is not available therefore consider not accounted for;

Finished units equal half the sales of the following month, will be closing stock of every month, including for Jun'18;

Budgeted production and costs are:

Production units: 40,000 | Direct materials per unit: R.10.00 | Direct Wages per unit: R. 5.00 Total factory overheads apportioned to product: R. 80,000;

Prepare production budget and production cost budget for second-half of 2018



# **What is Procurement management?**

- Businesses purchase goods & services routinely:
  - Raw materials: production of goods or services;
  - Office supplies: Pantry, house-keeping services etc.,
  - Third-party services: transportation, software services, maintenance services etc.,

## **Procurement management defined**

- An efficient manner of managing business purchases;
- Result: cost-savings; reduced turn-around-times; preventing frauds;
- Outcome: building excellent supplier-chain relationship

Direct Purchases	Indirect Purchases	Service Purchases
<ul style="list-style-type: none"> <li>➤ Inputs for manufacturing or in offering services to customers;</li> </ul> <p>Example:</p> <ul style="list-style-type: none"> <li>❖ Raw ingots, iron-ore, copper ore;</li> <li>❖ Laptops for consulting assignments;</li> <li>❖ Coffee beans or breads for restaurants etc.,</li> </ul>	<ul style="list-style-type: none"> <li>➤ Inputs for inhouse consumption – office supplies</li> </ul> <ul style="list-style-type: none"> <li>❖ Pantry services, coffee etc.;</li> <li>❖ Utility services like housekeeping;</li> <li>❖ Transport services like drivers or taxi/cab services;</li> <li>❖ WIFI / telephone services etc.,</li> </ul>	<ul style="list-style-type: none"> <li>➤ Third-party services for inhouse consumption</li> </ul> <ul style="list-style-type: none"> <li>❖ Computer server maintenances;</li> <li>❖ HR or manpower consulting;</li> <li>❖ Financial software services like SaaS etc.;</li> </ul> <ul style="list-style-type: none"> <li>❖ Indirectly facilitates revenue generations; included in operating overheads;</li> <li>❖ Requires cost management &amp; rationalization</li> </ul>

# Procurement process pipeline

Series of steps:

Begins with → purchase mandate or requisition;

Ends with → invoice payments (timely disbursement of payments);

A simplified structure: consists of

**People:** Agents authorized in the purchase process pipeline – from requisition to payment

**Processes:** Steps to be followed – without flouting – from beginning to end;

**Forms:** Documentary evidence, audit trail of procurement process pipeline

## Procurement process pipeline - Schema

Purchase agreement with supplier:

- SLA- for short-term / long-term contracts;

Purchase effected:

- Receiving goods/services;

Invoicing & approval process:

- Invoice raised by Supplier;
- Invoice verified and approved by committee or departmental heads;

Payment processing:

- Payment process initiated;
- Cheque/ bank transfer approved / instruments signed;
- Payment processed / instrument despatched



# **Conducive environment for fraud**

## **Conducive environment for fraud:**

- Opacity;
- Arbitrariness in decision making;
- Lack of procurement policy;
- Overriding interference at key decision levels;
- Limiting approval process to key associates;
- Improper criteria for selection & vendor approval;
- Vague vendor agreement, no SLA

# Fraud risks

## Risks of fraud:

- Over-invoicing;
- Padding-up pricing;
- Favoring vendors (close relatives);
- Kick-backs for vendor selection;

## Payments:

- Cash payments (part or full)
- Out-of-schedule payments
- Payments beyond scope of tender / services

# Automation

- Procurement process automation – for transparency;
- Removes human interference at key decision levels;
- Makes the approval process accessible to departmental associates;
- Approval automation records criteria for selection & vendor approval;
- Vendor agreements (SLA) input in system;
- Purchase & Payment automation to de-risk over-invoicing or padding-up
- Payment initiation and transfer automation to leave audit trail

# Company law - EU

## European Union

- Company laws at EU region as per Treaty on Functioning of European Union (TFEU, Article 49)
- Minimum standards across EU: shareholder interest protection, take-over rules, financial reporting, branch disclosure etc;
- Corporate laws applicable for specific EU states equally empowered to register legal entities;

## EU Legal Entities:

- ❖ Apart from countries having specific legal entities to suit their specific needs EU also has pan-EU entities;
- ❖ EEEIG: European Economic Interest group; cross-border trade; unlimited liability; no corporate taxes;
- ❖ Societas Cooperativa Europaea: EU cooperative;
- ❖ Societas Europaea (SE): Public limited (or European) company;
- ❖ Societas Privata Europaea: European private limited company; proposed in pan-European region; similar to Ltd, GmbH (Gesellschaft mit beschränkter Haftung) in Germany;
- ❖ Entities in specific regions: S.A. (Societe Anonyme, France/Italy) A.G. (Aktiengesellschaft, Germany) PLC (public limited company, UK), like public limited company;

# Company law - South Africa

## South Africa

- Company laws of 1973 replaced with Company Law of 2008;
- The types of companies are spelled in Sec 8 and 11C of this act;
- Replaces some flaws in the old statute

### ❖ S. African Legal Entities:

- ❖ Sole Proprietorship / Alleeneienaar: individual owner
- ❖ Partnership / Vennootskap;
- ❖ Companies: Public Limited company / private limited company;
- ❖ State-Owned Company: is State-Owned Enterprise, registered and included in the Public Financial Management Act 1999;
- ❖ Company Limited by Guarantee: Section 21 Not-for Profit company;
- ❖ Unlimited Liability Company (Sec. 53);

# **International Financial Reporting Standards**

**Need for Accounting Standards:**

Common standards for reporting financial transactions;

Applicable only for public limited companies;

Reporting is uniform and simple to comprehend;

Common standards irrespective of industries within a country;

Financial adjustments have a common theme or standard;

## **Why international accounting standards?**

Globalization permitted businesses engage in trade beyond borders;

Free capital flow meant business could raise capital beyond its home turf;

Investors' difficulty in comprehending health of business;

Financial reporting standards were specific to the region - home country;

Growing importance to adhere to standards of countries where capital sourced;

Business reporting became cumbersome: different regions and different reporting standards;

Corporations favored adopting a uniform International Accounting Standards

# International Financial Reporting Standards

Uniform financial event reporting standards;

Rules set-up by International Accounting Standards Boards (IASB);  
Earlier it was International Accounting Standards Committee;

Objective: Make Financial Statements: consistent, comparable & transparent;

Applicability: Across all countries who are part of the IASB standards;

USA – follows US-GAAP (United States Generally Accepted Accounting Principles);

Firms listing in US to be compliant of US-GAAP principles;

IFRS is renewed IAS;

IAS formed by IASC;

IFRS by new IASB

# International Financial Reporting Standards

Requires business to state these:

Statement of Financial Position – Balance Sheet;

Statement of Comprehensive Income – Income & Expenditure statement;

Statement of Changes Equity - reporting the changes in profits of the firm in a given period;

Statement of Cash-flow: reporting cash flows separating them under:

Financing

Operations

Investing

## US-GAAP vs IFRS

### US-GAAP

- US-GAAP based on Rules;
- Is very detail in reporting standards;
- Flouting rules is not an option;
- Not prone to interpretation

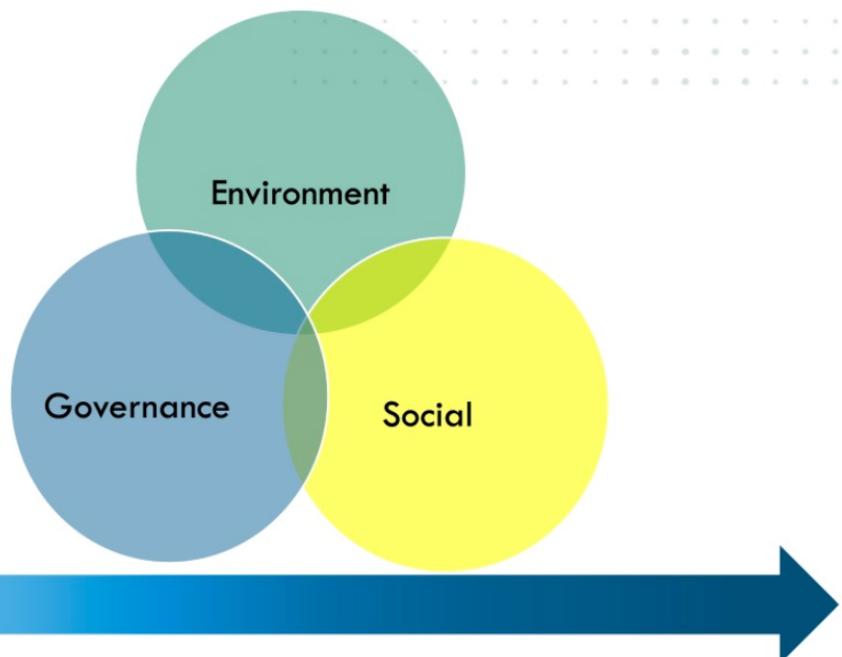
### IFRS

- IFRS based on principles;
- Is less in detail;
- Individual countries can have accounting standards within IFRS framework;
- Prone to multiple interpretations

## IFRS - Key standards

Standard	Purpose	Standard	Purpose
IFRS 1	First-time adoption of IFRS	IAS 16	Property Plan Equipment
IFRS 3	Business Combination	IAS 10	Events after the reporting period
IFRS 10	Consolidated Financial Statement	IAS 21	Effects of foreign exchange
IFRS 13	Fair-value Measurement	IAS 2	Inventory
IAS 12	Income Tax reporting	IAS 38	Intangible assets (good will, patents)
IAS 15	Information Reflecting the Effects of Changing Prices	IAS 36	Impairment of assets

## Governance - ESG framework



# **Environment social & governance model**

## **Environment:**

- Be sensitive to climate with environmentally friendly business practice
- Manufacturing or services truly respects effects on environment

## **Social:**

- Excellent labor practices
- Work-place practices respects diversity and inclusiveness

## **Governance:**

- Organisation adopting policies and best practices to govern itself
- Complies with law & meets needs of external stakeholders as well

# Time value of money

A rupee / currency which is received today, is more valuable than a rupee /currency received in future.

## Rationale of time preference for money

Uncertainty

Current Consumption

Possibility of Investment Opportunity

### Case: Something to smile about?

NEW YORK, NY - Colgate has been creating smiles the world over for the past 200 years. However, the smiles are not limited to users of its immensely popular toothpaste. Colgate's financial and stock price performance during the past decade has given plenty for its shareholders to smile about. Stock price has more than doubled over this period, generating average returns for Colgate's stockholders to the tune of 12.5% per year, almost double that on the S&P 500 over a comparable period.

Earnings have doubled even though shareholder capital actually declined, indicating that the earnings growth has been fueled by improving productivity with which Colgate uses its capital



## Case: Something to smile about?

One of the world's oldest corporations, Colgate today is truly global company, with a presence in almost 200 countries and sales revenues of above \$12 Billion. Its brand name - most famously associated with its toothpaste - is one of the oldest and best recognized brands in the world.

A total consumer orientation, constant innovation, and relentless quest for improving cost efficiencies have been Colgate's hallmarks to success. Another key feature in Colgate's strategy has been its extremely generous dividend policy; over the past 10 years Colgate has paid out almost \$11 Billion to its shareholders through cash dividends and stock buybacks, which is significantly more than the money it has raised from its shareholder's in its entire history! Colgate's dividend policy reflects its management philosophy of staying focused on generating superior shareholder returns rather than persuading a strategy of misguided growth. Small, in Colgate's case, has certainly been beautiful.

## Compounding and discounting

$$FV = (1+i)^n$$

- The process of adding interest each year to an initial capital sum
- **FV = FUTURE VALUE:** Amount to which an investment will grow after earning interest.
- **COMPOUND INTEREST:** Interest earned on interest
- **SIMPLE INTEREST:** Interest earned only on the original investment; no interest is earned on interest.

# Compounding and discounting

- Rs.100 interest at the end of the year will be Rs.110
- Value of investment
- Growth factor  $(1+10) = 1.10$
- Initial investment  $x(1+r)$   
 $Rs.100x(1.10) = Rs.110$

## Compounding and discounting

What if you leave this money in the bank for a second year ?

- Opening balance: Rs.110 at 10%p/a
- Year 2:  $.10 \times 110 = 11$
- $110 + 11 = Rs.121$
- $Rs.100 \times (1.10)^2 = 121$

## Compounding and discounting

$$PV = \frac{C}{(1+i)^n}$$