



Sharing in teaching BAFS – Management Module

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Chairman of Hong Kong Association for Business Education

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teamwork

Financial Management under AL – Business Studies

Sources of capital

- (i) Short term capital
- (ii) Long term capital
- (iii) Factors affecting choice of the above

Financial markets

Subsumed in Compulsory Part

- (i) Primary and secondary markets
- (ii) Capital and money markets

The nature of financial statements

Basic understanding of financial statements: balance sheets and income statements (study of basic bookkeeping is not required)

The nature and significance of key financial ratios

Types of financial ratios: liquidity, profitability, activity, leverage and equity ratios

Current assets management

- (i) Cash flow and its importance
- (ii) Stock control
- (iii) Debtors management

Capital budgeting

- (i) The concept of discounted cash flow
- (ii) Methods, their advantages and disadvantages: NPV, IRR, average rate of returns, payback method

The use of budgets for management guidance

Planning and control

Revenue and cost

Cost behaviour - deleted

- (i) Capital and revenue
- (ii) Fixed and variable costs
- (iii) Linear breakeven analysis and its limitations

Comparison between BAFS and AL Syllabuses



BAFS – Management Module	AL – Business Studies
<p><i>Financial Management</i></p> <p>Budgeting</p> <ul style="list-style-type: none">– Explain the purposes of budgeting.– Describe the usefulness and limitations of budgetary control.– Identify the causes of budgeting variance and propose remedial action.	<p><i>Financial Management</i></p> <p>The use of budgets for management guidance</p> <p>Planning and control</p>

Comparison between BAFS and AL Syllabuses



BAFS – Management Module

Financial Management

Sources of Financing

- Compare different sources of financing: **debt and equity financing**, **short-term and long-term financing**, and **internal and external financing**.
- Apply the basic principles for **selecting financing methods**.

AL – Business Studies

Financial Management

Sources of capital

- **Short term capital**
- **Long term capital**
- Factors affecting **choice of the above**

Comparison between BAFS and AL Syllabuses

BAFS – Management Module	AL – Business Studies
<p data-bbox="349 520 815 564"><i>Financial Management</i></p> <p data-bbox="349 600 972 644">Working Capital Management</p> <ul data-bbox="360 679 1133 1142" style="list-style-type: none"> <li data-bbox="360 679 1133 767">– Explain the importance of working capital management. <li data-bbox="360 823 1133 951">– Describe the basic principles of cash management and the relevance of cash budgeting. <li data-bbox="360 1007 1133 1142">– Analyze the factors affecting the formulation of accounts receivable and accounts payable policies. <p data-bbox="349 1190 1122 1374">Explain the objectives of inventory management and apply simple inventory control techniques: Economic Order Quantity (EOQ) and re-order level methods.</p>	<p data-bbox="1167 520 1637 564"><i>Financial Management</i></p> <p data-bbox="1167 600 1738 644">Current assets management</p> <ul data-bbox="1178 679 1760 903" style="list-style-type: none"> <li data-bbox="1178 679 1760 724">– Cash flow and its importance <li data-bbox="1178 775 1469 820">– Stock control <li data-bbox="1178 871 1603 916">– Debtors management

Comparison between BAFS and AL Syllabuses

Financial Analysis

BAFS – Compulsory Part

Basic Ratio Analysis

- State the general functions of accounting ratios.
- Calculate and interpret the following ratios: **gross profit ratio**, **net profit ratio**, working capital/**current ratio**, quick/**liquid ratio** and **return on capital employed**.
- Evaluate the **profitability** and **liquidity** of a business using accounting ratios.

I. Financial Analysis

BAFS – Management Module

3(a) *Financial Management*

Financial Analysis

- Explain the role of financial management in running an organisation.
- Assess business performance from a range of accounting ratios in terms of **profitability**, **liquidity**, **solvency** and **management efficiency**.

AL – Business Studies

Financial Management

The nature of significance of key financial ratios

Types of financial ratios: **liquidity**, **profitability**, **activity**, **leverage** and **equity ratios**

Activity ratios :

Asset turnover ratio, Inventory turnover ratio, Debtors turnover ratio & Creditors turnover ratio.

Leverage and equity ratios:

Debt to equity ratio, Total debt to total assets, EBIT to Interest

I. Financial Analysis

AL – Principles of Accounts

Analysis and Interpretation of Financial Statement/

Raito analysis

Calculation of accounting ratios
Uses and limitations of ratio analysis

Evaluation of **profitability, liquidity, management efficiency, investment return,** and **financial stability.**

BAFS – Accounting Module

Financial Analysis

- Describe the following types of financial statement analysis: ratio analysis, trend analysis, horizontal analysis and vertical analysis.
- Calculate ratios and comment on a company's **profitability, liquidity, solvency, management efficiency** and return on investment: **mark-up, margin, inventory turnover, days' sales in accounts receivable, days' purchases in accounts payable,** accounts receivable turnover, accounts payable turnover, **earnings per share, total assets turnover, gearing, dividend cover** and **price-earnings ratio.**
- Propose remedial actions which will improve the financial performance of a company.
- Explain the functions and limitations of accounting ratios in financial analysis.

III. Comparison Table

	Compulsory Part	Accounting Module	Management Module
1. Liquidity / Short-term solvency	<ul style="list-style-type: none"> ➤ Current / Working capital ratio ➤ Liquid / Quick Ratio 		<ul style="list-style-type: none"> ➤ Liquidity
2. Profitability	<ul style="list-style-type: none"> ➤ Gross profit ratio ➤ Net profit ratio ➤ Return on capital 	<ul style="list-style-type: none"> ➤ Mark-up ➤ Margin 	<ul style="list-style-type: none"> ➤ Profitability
3. Management Efficiency		<ul style="list-style-type: none"> ➤ Inventory turnover ➤ Accounts receivable turnover / Days' in accounts receivable ➤ Accounts payable turnover / Days' purchases in accounts payable ➤ Total assets turnover 	<ul style="list-style-type: none"> ➤ Management Efficiency
4. Long-term solvency		<ul style="list-style-type: none"> ➤ Gearing 	<ul style="list-style-type: none"> ➤ Solvency
5. Return on investment		<ul style="list-style-type: none"> ➤ Earnings per share ➤ Price-earning ratio ➤ Dividend cover 	

III. Comparison Table

	Compulsory Part	Accounting Module	Management Module
Additional Remarks	<ul style="list-style-type: none">➤ State the general functions of accounting ratios	<ul style="list-style-type: none">➤ Describe financial statement analysis: Ratio analysis Trend analysis Horizontal analysis Vertical analysis➤ Propose remedial actions➤ Explain the functions and limitations of using accounting ratios	<ul style="list-style-type: none">➤ Explain the role of financial management in running an organization

BAFS L&T Resource Kit

Elective Part – Management Module



M01 Ratio Analysis



M02 Capital Investment Appraisal



M03 Risk Management



M04 Performance Management



M05 Motivation



M06 Role of Marketing



M07 Marketing Research



M08 Customer Behaviour



M09 - Marketing Mix



M10 E-Marketing

BAFS L&T Resource Kit

Elective Part – Accounting Module



A01 Depreciation



A02 Financial Reporting



A03 Bank Rec & Correction of Errors



A04 Financial Analysis



A05 ICT Application



A06 Ethical Issues



A07 Job Costing



A08 Marginal & Absorption Costing



A09 AC Decision Making



A10 Cost-volume-profit analysis

Comparison between BAFS and AL Syllabuses

BAFS – Management Module	
<i>Financial Management</i>	<i>AL – Business Studies</i>
<p>Capital Investment Appraisal</p> <ul style="list-style-type: none"> - Evaluate financial and non-financial factors affecting capital investment decisions. - Apply the basic capital investment appraisal methods to evaluate capital projects: payback period, net present value, internal rate of return and accounting rate of return. - Compare the <u><i>usefulness and limitations</i></u> of different capital investment appraisal methods. 	<p>Capital budgeting</p> <ul style="list-style-type: none"> - The concept of discounted cash flow - Methods, their <u><i>advantages and disadvantages</i></u>: NPV, IRR, average rate of returns, payback method <p><i>AL – Principles of Accounts</i></p> <p>Investment appraisal</p> <ul style="list-style-type: none"> - Financial factors affecting investment decisions <ul style="list-style-type: none"> ➤ ascertainment of future cash flows, payback, and accounting rate of return ➤ net present value and internal rate of return (Calculation of IRR is not required) - Non-financial factors affecting investment decisions

2011 Mock Paper 2

Question Four (20 marks)

Topics related:

Investment Appraisal

- | | | |
|----|---------------------------|---------|
| 1) | Net present value method | 9 marks |
| 2) | Payback period | 3 marks |
| 3) | Accounting rate of return | 8 marks |
| 4) | Analysis and appraisal | 3 marks |

Mock Exam-Question 4(20%)

- 4) Generally, some students failed to take care the requirements of insurance premium and the rising of servicing and fuel charges :

Insurance premiums are to be paid **at the start of each year** and are expected to rise over the next three years. Insurance for each fleet is expected to cost:

	Year 1	Year 2	Year 3
	\$	\$	\$
Armada	7,000	8,050	9,255
<u>Carioka</u>	10,500	11,075	13,888

Servicing and fuel charges are also expected to rise over the next three years. Servicing and fuel charges for each fleet are expected to cost:

	Year 1	Year 2	Year 3
	\$	\$	\$
Armada	4,050	4,155	4,270
<u>Carioka</u>	6,700	6,870	7,057

All cash flows except insurance arise **at the end of the relevant year**.

Mock Exam-Question 4(20%)

4a) Fairly answered. Some failed to calculate correctly due to ignorance of purchase discounts, disposal value, and insurance premiums.

Model Armada	Year 0	Year 1	Year 2	Year 3	Total
End of the year	\$	\$	\$	\$	\$
Cost $\$7\,000 \times 5 \times 95\%$	(33,250)				
Insurance	(7,000)	(8,050)	(9,255)		
Fuel & servicing		(4,050)	(4,155)	(4,270)	
Hire fees		30,000	30,000	30,000	
Disposal value				<u>12,500</u>	$\$2\,500 \times 5$
	(40,250)	17,900	16,590	38,230	
DF=12%	*1	*0.8929	*0.7972	*0.7118	
	(40,250)	15,983	13,226	27,212	16,171

Mock Exam-Question 4(20%)

4a) Continued.

Model Carioka

End of the year	Year 0	Year 1	Year 2	Year 3	Total
	\$	\$	\$	\$	\$
Cost $\$16\,000 \times 5 \times 85\%$	(68,000)				
Insurance	(10,500)	(11,075)	(13,888)		
Fuel & servicing		(6,700)	(6,870)	(7,057)	
Major repair			(50,000)		
Hire fees		66,000	66,000	66,000	
Disposal value				<u>35,000</u>	$\$7\,000 \times 5$
	(78,500)	48,225	(4,758)	93,943	
DF=12%	<u>*1</u>	<u>*0.8929</u>	<u>*0.7972</u>	<u>*0.7118</u>	
	(78,500)	43,060	(3,793)	66,869	27,636

Mock Exam-Question 4(20%)

4b) Most students failed to recognise how to apply the payback period, and the adjustment of insurance premium.

	Model Armada	Model Carioka
Initial investment	\$ 33,250	\$ 68,000
Cash flows within the year		
Year 1	$30,000 - 7,000 - 4,050 = 18,950$	$66,000 - 10,500 - 6,700 = 48,800$
Year 2	$30,000 - 8,050 - 4,155 = 17,795$	$66,000 - 11,075 - 6,870 = 48,055$
Year 3	$30,000 - 9,255 - 4,270 + 12,500 = 28,975$	$66,000 - 13,888 - 7,057 - 50,000 + 35,000 = 30,055$
Payback period for Armada		Payback period for Carioka
$= [1 + (33,250 - 18,950)/17,795]$ years		$= [1 + (68,000 - 48,800)/48,055]$ years
$= [1 + 14,300/17,795]$ years		$= [1 + 19,200/48,055]$ years
= 1.80 years		= 1.40 years

Mock Exam-Question 4(20%)

4c) Students mixed up with previous a and b, and got lost in the preparation of Income Statement.

(c) **Income Statement** in columnar form for Armada

For year ended	Year 1	Year 2	Year 3	Total
Revenue	\$ 30,000	\$ 30,000	\$ 30,000	
Insurance	(7,000)	(8,050)	(9,255)	
Fuel & servicing	(4,050)	(4,155)	(4,270)	
Depreciation $(33,250-12,500)/3$	<u>(6,917)</u>	<u>(6,917)</u>	<u>(6,916)</u>	
Net profit	12,033	10,878	9,559	32,470

Mock Exam-Question 4(20%)

4 c) Continued.

Income Statement in columnar form for Carioka

For year ended	Year 1	Year 2	Year 3
	\$	\$	\$
Revenue	66,000	66,000	66,000
Insurance	(10,500)	(11,075)	(13,888)
Fuel & servicing	(6,700)	(6,870)	(7,057)
Major repair			(50,000)
Depreciation $(68\,000 - 35\,000) / 3$	<u>(11,000)</u>	<u>(11,000)</u>	<u>(11,000)</u>
Net profit/ (Loss)	37,800	37,055	(15,945)

Mock Exam-Question 4(20%)

- 4d) Unfamiliar to apply the average accounting rate of return method.

Accounting rate of return for Armada:

$$\text{Average net profit} = \$(12,033 + 10,878 + 9,559) / 3 = \$32,470 / 3 = \$10,823.33$$

$$\text{Average capital} = \$(33,250 + 12,500) / 2 = \$22,875$$

$$\text{Accounting rate of return} = \$10,823.33 / \$22,875 * 100\% = \mathbf{47.32\%}$$

Accounting rate of return for Carioka:

$$\text{Average net profit} = \$(37,800 + 37,055 - 15,945) / 3 = \$58,910 / 3 = \$19,636.67$$

$$\text{Average capital} = \$(68,000 + 35,000) / 2 = \$51,500$$

$$\text{Accounting rate of return} = \$19,636.67 / \$51,500 * 100\% = \mathbf{38.13\%}$$

Mock Exam-Question 4(20%)

4e) Unable to mention about any reservation of using NPV in evaluating a project. Some ignored the use of payback period for evaluation.

(e) On financial grounds, Andre should purchase the fleet of Carioka cars. This fleet gives the **higher** NPV value and it has the **shorter payback** period. The accounting rate of return for Carioca is 38.13% which is lower than Armada but the method of accounting rate of return did not account for the reason of time value of money which is important for investment appraisal. The feasibility of net present value method depends on the accuracy of the discount rate. The rate is affected by the market interest rate, inflation, risk preference, uncertainty of the investment involved etc, therefore, it may be rather subjective to rely on net present value method to evaluate an investment. (3 marks)

Some problems – Payback Period

In calculating Payback Period, we have a very basic and fundamental assumption (very often by implicit assumption without explicit statement) that the resultant cash inflows/outflows are evenly spread throughout the year (instead of at a particular point of time during the year).

Let me illustrate my point by an example.

Initial investment of the project at 1.1. Year1 = \$1,000

Returns from the investment:

1st instalment of cash inflow \$800 at 30.6. Year 1

2nd instalment of cash inflow \$400 at 1.1. Year 2

Some problems – Payback Period

What is the Payback Period for the above project?

Interpretation One:

What is the exact point of time when the initial investment of \$1,000 is recovered?

The exact point of time of recovery by considering the exact timing of cash inflow is 1.1. Year 2

Does it mean that the Payback Period is 1 year?

Some problems – Payback Period

What is the Payback Period for the above project?

Interpretation Two:

The normal practice to calculate the payback period in most textbooks will be –

$$1 \text{ year} + \$(1,000-800) / \$400 = 1.5 \text{ years}$$

(the implicit assumption for this answer is that the cash inflow of \$400 is spread evenly throughout the year)



Thank you for your patience!