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Notes

Financial Management

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	<i>Page</i>
Welcome to your ExPress notes	3
1. Financial Management Function	4
2. Financial Management Environment	7
3. Working Capital Management	9
4. Investment Appraisal	16
5. Business Finance	32
6. Cost of Capital	38
7. Business Valuations	41

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Steve Crossman
CEO The ExP Group

“Hello”

Thank you for downloading a copy of these ExPress notes and I hope you find them useful for your studies.

We provide these ExPress notes free of charge to individual students as part of our CSR initiatives. The notes are designed to help students assimilate and understand the most important areas for the exam as quickly as possible.

A word of warning though in that they have not been designed to cover everything in the syllabus so you should only use these notes for either an overview of the key areas before you start your main studies or as part of your final revision in the run up to your exams.

Importantly though, we want you to be successful in your exams so good luck with your studies and please do let us know how you get on.

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All the best
Steve

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About The ExP Group

We were born with one passion, with one aim, with one desire. To use technology the way it should be used. To use technology to open up education, and in particular financial education, to whoever needs it regardless of their income, wealth, race, sex, religion or location.

We wanted to use technology to empower individuals to develop themselves through financial expertise, organisations to improve their performance through enhanced human capital and ultimately communities and families to benefit as a result.

We're on target and since our birth we have had the privilege of working with and learning from inspirational individuals and organisations from all 4 corners of the world in countries as varied as the UK in the north, Singapore in the east, South Africa in the south and the Cayman Islands in the west.

We're only part way through our journey but we're doing better than we expected. The best is yet to come though,

Education+Technology=Ethical Empowerment.

Thank you for being part of our story.



Financial Management Function

Key Knowledge – The Nature and Purpose of Financial Management

The main purpose of financial strategy is to ensure that financial resources are available to the organization in support of its overall corporate objectives, which include financial objectives.

Management accounting is a set of tools and disciplines measuring corporate performance and to facilitate decision-making; it is designed and implemented in coordination with the company's strategy.

Financial accounting is concerned with maintaining the records of the transactions of the firm and preparing financial statements for the benefit of shareholders (and other external audiences) in conformity with established accounting standards.

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In pursuing its financial objectives, the firm must ensure that those objectives are congruent – i.e. consistent – with its overall corporate strategy.

Key Knowledge – Stakeholders and Impact on Corporate Objectives

Stakeholder groups

- Shareholders: As owners of the business, they rank supreme, as reflected in US/UK models of corporate governance;

- Lenders: Important if the business relies heavily on providers of loan capital (banks, bondholders);
- Directors: The executive directors or senior management of the business are central since they have “hands-on” power and can serve their own interests (giving rise to agency risk);
- Employees: Often referred to as a company’s “most valuable asset”; they must be motivated and adequately compensated;
- Customers: No customers, no business! How influential they are or how carefully management needs to listen to their concerns depends on the type of business activity and the competitive environment;
- Suppliers: Good and reliable suppliers can be critical to corporate success;
- Government: They have two major interests: (a) they receive revenue via taxes and (b) benefit indirectly when firms create employment. Environmental and other regulatory concerns are also within the scope of the government’s interest;
- Public: The general public, its opinions and ability to exert pressure through lobby groups are all relevant factors for businesses that pollute, are involved in nuclear power, or carry out other activities that may be controversial (e.g. abortion clinics).

Conflicting stakeholder interests

Conflicting interests can exist between various stakeholder groups.

Management must examine the degrees of stakeholder influence and actively manage the relationship with relevant stakeholders.

Agency theory

Agency theory addresses the risk that management will not act in the best interests of the shareholders, but will make decisions that will serve its own interests.

Examples of self-serving management behavior could include: (a) artificially boosting corporate profits in the short-term in order to earn bonuses; (b) paying too much to acquire another company for reasons of prestige or in order to “build empires”; (c) rejecting opportunities, such as takeover bids, or restructuring initiatives, that might jeopardize their positions (an orientation to maintaining the “status quo”).

Influencing managerial behavior

In order to cause managers to behave in a way consistent with stakeholder interests, rewards and bonus schemes need to be carefully designed. This can be seen as the “internal” dimension to corporate governance. The other dimension -- “external” -- comes in the form of regulation.

Scope of strategic performance measures in private sector

Shareholder value measurements focus on creation of shareholder value as fundamental aim of profit oriented companies.

Long-term wealth maximization is not always consistent with the “artificial” inflation of profits in the short-term. If a company stops investing, for example, it can boost its short-term profitability, but this may come at the expense of the company’s medium- to long-term competitiveness.

The following are some of the financial measures typically used by companies to measure performance.

Return on Investment (ROI/ROCE)

(Accounting PBIT / Accounting Capital Employed) * 100%

Accounting Capital Employed = Total Assets – Current Liabilities = Total Non-Current Assets, net + Working Capital

Disadvantage: ROI/ROCE increases as investment centre’s fixed assets grow older, thus a ROI improvement over time (or a better ROI compared to another division) may be partly attributable to the age of the assets used.

Consequently, gross value of fixed assets may be used in measuring performance based on ROI.

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Earnings per Share (EPS)

Net income less any preferred dividends divided by the number of shares outstanding.

Return on Equity

Net income divided by shareholders’ equity.

Key Knowledge – Financial and Other Objectives in Non-for-Profit Organisations

Profit and Not-for-profit organisations

Profit-seeking organizations exist ultimately to create wealth for their owners.

Non-profit (or not-for-profit) organizations are created to accomplish a pre-defined mission, such as the delivery of a service; they are expected to do so in an economical manner.



Financial Management Environment

The Big Picture

The economic environment for business

The general economic environment, and in particular the influence of governments – through its monetary and fiscal policies – has a far-reaching impact on most businesses.

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Key Knowledge – The impact of macro-economics

Businesses must also take macro-economic factors into account:

- Projected level of market demand for goods and services in the economy;

In a very loose sense, our government policies are likely to be adjusted with respect to:

- (a) Monetary policy: Effect on interest rates, exchange rates and inflation, (the latter may eventually increase with economic recovery);
- (b) Labour policy: If labour markets tighten, how fast will restrictions (imposed on foreign labor, for example) be relaxed?
- (c) Fiscal policy: Tax increases (both personal and corporate);
- (d) Trade policy: to what degree is any protectionism likely to stay in place?

Again, actively keeping up with reading on these issues will be the best way to prepare for this section of the exam.

Key Knowledge – The nature and role of financial markets and institutions

Financial markets and institutions have achieved such a degree of global integration that shocks in one part can have systematic implications across all markets.

Stock markets

A stock exchange is an organized and regulated market place which permits:

- (i) Companies to raise capital through issuing new shares or debentures (collectively known as securities); the proceeds of such issues go to the company issuing them - this is called the "primary market"; and
- (ii) Investors to buy and sell already issued securities, called the "secondary market".

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How stock markets operate

The operation of a stock market is accomplished through an auction system, where prices are publicly posted after trades are executed, two-way prices are provided (i.e. quoting buy and sell prices), thus ensuring liquidity to the market.

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Working Capital Management

Key Knowledge – The nature, elements and importance of working capital

This is a core function of management which has day-to-day implications.

Working capital definition: Current assets – Current liabilities

This is an accounting definition. The essential and analysis of working capital management focuses on the “operating” elements of current assets and liabilities:

- Cash
- Inventory
- Receivables
- Payables

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Key Knowledge – Management of inventories, accounts receivables, accounts payable and cash

These elements are linked through the Cash conversion cycle, also known as the Cash Operating Cycle.

