



**The Association of  
Certified Public Accountants (Int)  
Financial Management**

**Contents**

	<b>Page</b>
<b>Nature and Framework</b>	
General	2
Users of Financial Information	2
Theory of Business Finance	7
Requirements of Financial Management	8
Relationship between Management and Shareholders	9
Measuring Financial Performance	10
Usefulness of Ratio Analysis	12
Social Responsibilities of a Business	15
Cost Benefit Analysis	16
Cost Effectiveness Analysis	17
Sources of Business Finance	18
Financial Markets	21
Market factors	27
Risk/Return Trade-off	31
<b>The Economic Environment</b>	
Interest Rates	34
Effects on Inflation	37
Exchange Rates	37
Government Influence on Business	38
<b>Permanent and Long-term Capital</b>	
Introduction	48
Share Capital	48
Internally Generated Finance	53
Management of Factors Affecting Share Prices	58
Valuation of Shares	58
Issue of Shares	61
Debentures and Loan Stocks	64
Risk and Return	66
<b>External Finance</b>	
Introduction	70
Short-term Capital	70
Medium-term Capital	73
Obtaining Funds Internally	77
Small Company Financing	80
<b>Capital Structure and Gearing</b>	
Introduction	86
Capital Gearing	86



**The Association of  
Certified Public Accountants (Int)  
Financial Management**

**Contents**

	<b>Page</b>
<b>Factors Determining Capital Structure</b>	<b>87</b>
<b>Practical Approach to Gearing</b>	<b>91</b>
<b>Summary of Capital Mix</b>	<b>92</b>
<b>Capital Budgeting</b>	<b>92</b>
<b>Earnings and Gearing</b>	<b>93</b>
<b>Capital Restructuring</b>	<b>96</b>
<b>Values and Earnings</b>	<b>97</b>
<b>The Effect of Capital Rationing and Risk</b>	
<b>Introduction</b>	<b>102</b>
<b>The determinants of an investment Decision</b>	<b>102</b>
<b>Consideration of the Lenders</b>	<b>108</b>
<b>Treatment of Risk and Uncertainty</b>	<b>109</b>
<b>Sensitivity Analysis</b>	<b>111</b>
<b>Probability Estimates of Cash Flows</b>	<b>113</b>
<b>Analysing Company Performance</b>	
<b>Introduction</b>	<b>120</b>
<b>Ratio Analysis</b>	<b>120</b>
<b>Importance of other Evidence and Correlation</b>	<b>126</b>
<b>Using Ratio Analysis</b>	<b>126</b>
<b>Advantages and Disadvantages of Inter-firm Comparisons</b>	<b>133</b>
<b>Evaluation of Corporate Securities</b>	<b>133</b>
<b>Situational Analysis</b>	<b>133</b>
<b>Performance measurement in the Public Sector</b>	<b>134</b>
<b>Performance measurement in the Service Sector</b>	<b>134</b>
<b>Discounted Cash Flow &amp; Impact of Inflation</b>	
<b>Introduction</b>	<b>138</b>
<b>Nature of profit and financial strategy</b>	<b>138</b>
<b>Capital Investment appraisal techniques</b>	<b>139</b>
<b>Return on Investment (Accounting Rate of Return - ARR)</b>	<b>139</b>
<b>Impact on Inflation on investment appraisal</b>	<b>146</b>
<b>Interest Rates</b>	<b>147</b>
<b>Financial Management Tables</b>	<b>151</b>
<b>Developing Business Plans</b>	
<b>Introduction</b>	<b>160</b>
<b>Financial Management Decisions</b>	<b>160</b>
<b>Building the Business Plan</b>	<b>161</b>
<b>Analysing Business Plans</b>	<b>163</b>
<b>Assessing and Managing Risk</b>	<b>164</b>



**The Association of  
Certified Public Accountants (Int)  
Financial Management**

**Contents**

	<b>Page</b>
<b>Developing Business Plans</b>	
Change Management	166
Long-term objectives and strategy	168
Top-Down Versus Bottom-up Planning Systems	168
Long-term Financial Planning	169
<b>Valuation of Business</b>	
Introduction	172
Reasons for share valuation	172
Methods of share and company valuation	172
Other relevant factors	178
<b>Mergers and Acquisitions</b>	
Introduction	180
Strategies for Growth	180
Economic Justification for Growth via Acquisition	181
Tactics for Acquisitions and Mergers	182
Regulations on Takeovers	183
Defence Against an Unwelcome Takeover Bid	186
Consideration for Mergers	187
Trends in Takeovers	189
<b>Divestment and Capital Reconstruction Schemes</b>	
Introduction	192
Success and Failure of Mergers and Takeovers	192
Withdrawal or Abandonment	194
Management Buy-Outs (MBO)	194
Symptoms of Corporate Collapse	197
Predicting Company Failure	197
Company Liquidation	199
Capital Reconstruction Schemes	199
Stock Exchange Notification	200
Share Repurchases	201
<b>Investment Analysis Techniques and Portfolio Theory</b>	
Introduction	204
Risk and Aversion	204
Expected Return	204
Risk	205
Diversification	206
Graphical Representation	210
Application of Portfolio Theory	213



**The Association of  
Certified Public Accountants (Int)  
Financial Management**

**Contents**

	<b>Page</b>
Selected versus Random Portfolios	214
Popular Misconceptions	214
Practical Difficulties	215
Limitations of Portfolio Theory	215
<b>Capital Asset Pricing Model</b>	
Introduction	218
Risk	218
The Calculation of Beta	223
Assumptions of the CAPM	224
Acceptance of the Model for use in Capital Investment Decisions	225
Limitations of CAPM	225
Application of the Model	227
The Capital Asset Pricing Model and Portfolio Management	228
<b>Cost of Capital</b>	
Introduction	232
Effects of Risk on the Cost of Capital	232
Cost of Equity	232
Cost of Preference Shares	235
Cost of Debt Capital	235
Cost of Internally Generated Funds	239
Weighted Average Cost of Capital	240
Assessment of Risk in the Debt Versus Equity	242
Cost of Capital for Unquoted Companies	244
Cost of Capital for not-for-profit Organisations	244
Relevance of cost of Capital	244
Capital Gearing	244
Approaches to Gearing	247
<b>Capital Structure Decisions and the Interaction of Investment and Financing Decisions</b>	
Introduction	250
Factors Determining Capital Structure	250
Modigliani and Miller	253
A Practical Approach to Gearing	249
Capital Gearing and the Effects on Equity BETAS	260
<b>Corporate Dividend Policy</b>	
Introduction	264
Practical influences on Dividend Policy	264
Availability of Internal Funds	264



**The Association of  
Certified Public Accountants (Int)  
Financial Management**

**Contents**

	<b>Page</b>
<b>Provisions set Aside out of Profit</b>	<b>264</b>
<b>Retention of Profits and Payment of Dividends</b>	<b>265</b>
<b>Effect of Dividends and Retained Earnings on Share Prices</b>	<b>266</b>
<b>Other Factors Affecting Dividend Policy</b>	<b>267</b>
<b>Concept of Signalling Investor and Market</b>	<b>269</b>
<b>Non Dividend Transactions</b>	<b>270</b>
<b>Currency Risk</b>	
<b>Introduction</b>	<b>274</b>
<b>How is the Exchange Rate for a Currency Determined</b>	<b>274</b>
<b>Forecasting Exchange Rates</b>	<b>278</b>
<b>Methods of Reducing Risk</b>	<b>280</b>
<b>Forward Exchange Contracts</b>	<b>282</b>
<b>Factors Affecting spot Rates and Forward Rates</b>	<b>285</b>
<b>Factors Which Govern Forward Rates and Determine the Premium or Discount</b>	<b>285</b>
<b>Translation Management of Foreign Currency</b>	<b>287</b>
<b>Translation Management Options</b>	<b>289</b>