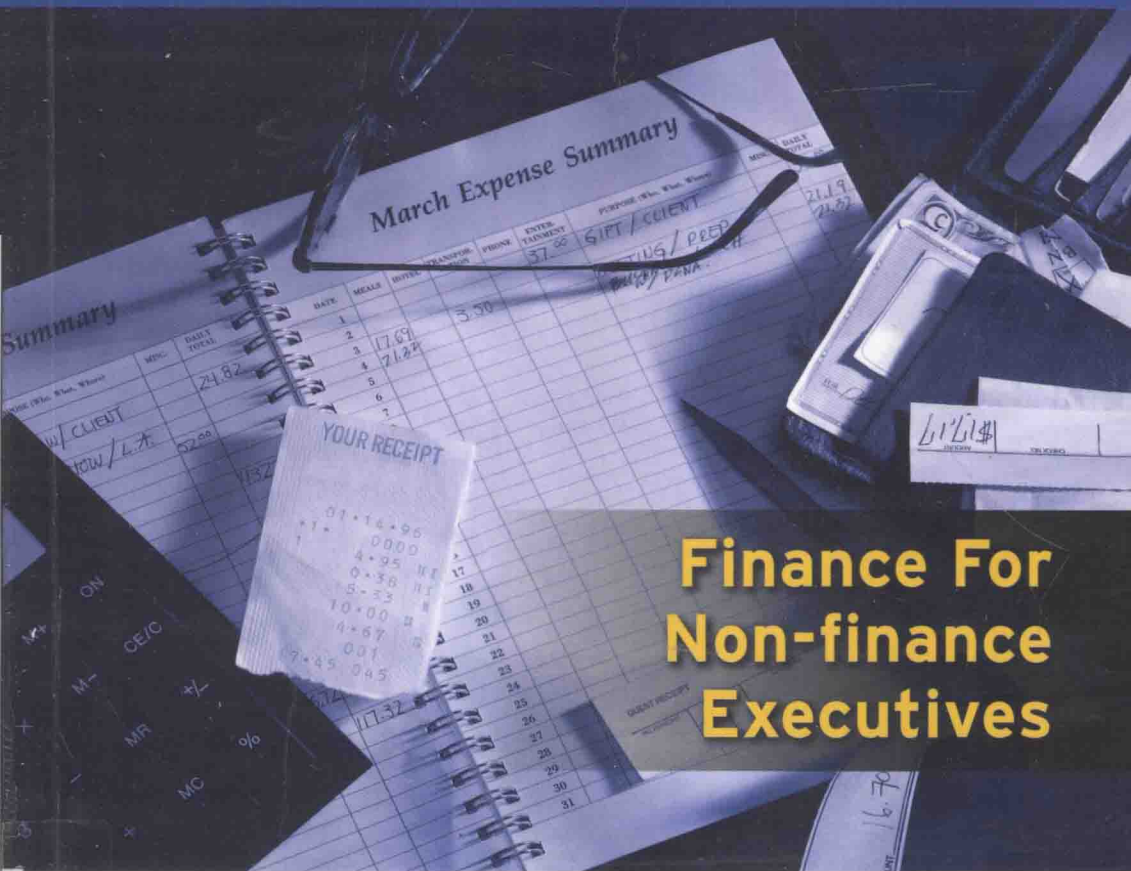


CFM-TMH Professional Series In **Finance**

# Finance Sense **4<sup>th</sup>** edition



**Finance For  
Non-finance  
Executives**

**Prasanna Chandra**



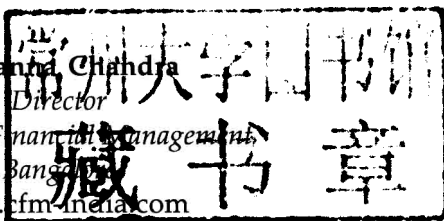
CFM-TMH Professional Series in Finance

# Finance Sense

Finance for Non-Finance Executives

FOURTH EDITION

Prasanna Chandra  
Director  
Centre for Financial Management  
Bangalore  
[www.cfm-india.com](http://www.cfm-india.com)



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Kuala Lumpur Lisbon London Madrid Mexico City Milan Montreal  
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**Tata McGraw Hill**

Published by Tata McGraw Hill Education Private Limited  
7 West Patel Nagar, New Delhi 110 008.

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Second reprint 2011  
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This edition can be exported from India only by the publishers,  
Tata McGraw Hill Education Private Limited.

ISBN-13: 978-0-07-068020-3

ISBN-10: 0-07-068020-5

Managing Director: *Ajay Shukla*

Head—Professional and Healthcare: *Roystan La'Porte*

Executive Publisher—Professional: *R Chandra Sekhar*

Asst. Sponsoring Editor—BGR: *Dipankar Das*

Manager—Production: *Sohan Gaur*

Manager—Sales & Marketing: *S Girish*

Sr. Product Specialist—BGR: *Priyanka Goel*

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Typeset at Script Makers, 19, A1-B, DDA Market, Paschim Vihar, New Delhi 110063,  
and printed at Gopsons Papers Limited, A2 & 3, Sector 64, Noida, U.P. 201301

Cover Printer: Gopsons

Cover Design: Kapil Gupta

**The McGraw-Hill Companies**

## **CFM-TMH Professional Series in Finance**

*Honorary Consulting Editor: Dr Prasanna Chandra*

The CFM-TMH Professional Series in Finance, a joint initiative of the Centre for Financial Management and Tata McGraw Hill Education, India, seeks to synthesise the findings of financial research with the concerns of practitioners. The aim of the books in this series is to convey the important developments in the theory and practice of finance in a rigorous, but relatively non-technical manner for the benefit of: (a) finance practitioners and (b) students of MBA.

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To  
My Brother  
**Prakash Chandra Shrimal**  
and  
My Sister-in-Law  
**Late Mangala Shrimal**

# Preface to the Fourth Edition

This book, along with its precursor *Managers' Guide to Accounting and Finance*, is 25 years old. Its longevity and popularity may be attributed to a growing number of readers who have found it useful, relevant, and readable.

Do you know how to do the following:

- Analyse financial statements
- Prepare financial forecasts
- Estimate the cost of a product
- Conduct break-even analysis
- Evaluate various alternatives relating to an operating decision
- Develop a budget
- Measure business performance
- Evaluate a capital budgeting proposal
- Determine the appropriate financing mix
- Assess the financial impact of changing credit policies
- Monitor the debtors position
- Evaluate an acquisition target
- Manage foreign exchange exposure
- Diagnose the levers of value creation

These are some of the important topics covered in this book. "Almost everything in business eventually boils down to the rupee sign", so the adage goes. Hence, irrespective of what your primary area of work is, you need a basic grounding in finance and accounting.

This book will help you to:

- Understand the financial and accounting reports used in business
- Appreciate the financial implications of your decision, and
- Communicate meaningfully with your colleagues in the language of accounting and finance.

This book will thus hone your finance sense which is essential for your professional or business success. It is divided into five parts which cover key areas of finance and accounting. A brief description of these parts is as follows:

*Part One* provides a firm grounding in financial statements, financial statement analysis, accounting mechanics, and financial forecasting.

*Part Two* discusses the key concepts, tools, and systems of cost accounting, budgeting, managerial decision making, and cost management.

*Part Three* presents an overview of the financial system, dwells on the ideas of compounding and discounting, and introduces the basic risk-return tradeoff in finances.

*Part Four* covers the key areas of financial management such as capital budgeting, financing strategy, sources of finance, and working capital management.

*Part Five* explores special topics like mergers, acquisitions, and restructuring, international finance, and value-based management. In addition, it provides a primer on macroeconomics.

### **Changes in the Fourth Edition**

Enthused by the encouraging response to the third edition, I added new material to enrich the book. More specifically, the following enhancements have been made:

- Two new chapters have been added:
  - Chapter 8 : Cost Management
  - Chapter 20 : Business Performance Measurement
- Five new sections have been added:
  - Section 1.9 : Financial Statements in the US
  - Section 2.4 : Standardised Financial Statements
  - Section 6.3 : Contribution Margin
  - Section 7.10 : Becoming Budget Savvy
  - Section 18.2 : Multinational Corporations

In addition, a number of revisions have been made in various chapters.

Due to the above enhancements, I believe that this book is an improvement over its predecessor.

I earnestly solicit suggestions and comments from the readers of the book for improving the next edition.

# Acknowledgements

I am grateful to the participants of a numerous executive development programmes for providing the stimulus to write this book. I am indebted to Dr P G Apte for contributing the chapter on Macroeconomics. I am grateful to Shri Venugopal Unni and Prof. Padmini Srinivasan for their valuable inputs and suggestions. I am thankful to Savita and Poornima for their help in preparing the manuscript of the book.

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**PART I**

**Financial Statements and  
Financial Accounting**

- 1. Financial Statements**
- 2. Financial Statement Analysis**
- 3. Accounting Mechanics**
- 4. Financial Forecasting**





# Financial Statements

Managers, shareholders, creditors, employees, suppliers, lenders, business partners, tax authorities, regulators, and other interested groups seek answers to the following important questions about a firm:

- *What is the financial position of the firm at a given point of time?*
- *How has the firm performed financially over a given period of time?*
- *What have been the sources and uses of cash over a given period of time?*

To answer the above questions, the accountant prepares three statements, the balance sheet, the profit and loss account, and the cash flow statement. The balance sheet shows the financial position (or condition) of the firm at a given point of time. It provides a snapshot and may be regarded as a static picture. The profit and loss account reflects the performance of the firm over a period of time. Finally, the cash flow statement displays the sources and uses of cash during the period.

Usually a firm has to prepare two sets of statements, one for financial reporting and the other for tax purposes. The statements meant for financial reporting are found in the annual report and are public; the statements for tax purposes are not public. This chapter discusses the former, not the latter.

This chapter provides a primer on financial statements. It is divided into nine sections as follows:

- Overview of business activities
- Basic concepts underlying financial accounting.
- How the accounting model works