



CA

INTERMEDIATE

FINANCIAL MANAGEMENT AND STRATEGIC MANAGEMENT



- ICAI Study Material Questions Covered
- RTP/MTP Questions Covered
- Past Year Exam Questions Covered

Book recommended by AIR 1

CA Sunil Keswani

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Chapter 1

Scope and Objectives of Financial Management

Past Exam Trend														
	M-18	N-18	M-19	N-19	N-20	J-21	J-21	D-21	M-22	N-22	M-23	N-23	M-24	S-24
Th.	4	2	-	3	4	4	2	2	2	-	-	2	4	-
Meaning of Financial Management		<p>“Financial management is concerned with the efficient use of an important economic resource, namely capital funds.”</p> <p>In other words, financial management Answers the following questions:</p> <ul style="list-style-type: none"> (a) Where to invest? i.e. Investment Decisions (b) From where to raise funds? i.e. Financing Decision (c) How much earning to be retained and how much to be distributed? i.e. Dividend Decision (d) How to manage working capital? i.e. Working Capital Management 												
Characteristics of Financial Management		<ul style="list-style-type: none"> (a) Essential part of Business Management (b) Continuous Administrative Function (c) Scientific and Analytical (d) Centralized Nature (e) Different from Accounting Function 												
Functions of Financial Management		<ul style="list-style-type: none"> (a) Procurement of funds – Funds can be obtained from different sources like equity, debt, debentures, preference shares etc. The cost of funds should be at the minimum level and for that a proper balancing of risk and control factors must be carried out. (b) Effective Utilization of Funds - The funds are to be invested in a manner such that they generate returns higher than the cost of capital to the firm. 												
Evolution of Financial Management		<ul style="list-style-type: none"> (a) Traditional Phase - During this phase, financial management was considered necessary only during occasional events such as takeovers, mergers, expansion, liquidation, etc. (b) Transitional Phase - During this phase, the day-to-day problems that financial managers faced were given importance e.g. problems related to funds analysis, planning etc. 												

	<p>(c) Modern Phase - Modern phase is still going on. The scope of financial management has greatly increased now. It is important to carry out financial analysis for a company. This analysis helps in decision making.</p>															
Importance of Financial Management	<p>It is a key to successful business. Its importance can be understood by the tasks involved in it which are as follows:</p> <ul style="list-style-type: none"> (a) Preparing budget to provide appropriate targets to various departments (b) Setting short term sales and cost targets for various departments (c) Managing the cash flow needs of the organization (d) Ensuring appropriate investment in fixed assets and working capital (e) Ensuring correct pricing decisions for the products or services (f) Tax planning to minimize tax burden of the organization 															
Objective of Financial Management	<p>(a) Profit Maximization - Based on this objective, the investment, financing and dividend policy decisions of a firm should be oriented to the maximization of profit. This objective leads to efficient allocation of resources, as resources tend to be directed to uses which in terms of profitability are most desirable.</p> <p>Limitations of profit maximization:</p> <ul style="list-style-type: none"> (1) Ignores risk; (2) Ambiguity; (3) Ignores the time value of money <p>(b) Wealth Maximization - Wealth / Value maximisation means that the primary goal of a firm should be to maximize its market value and implies that business decisions should seek to increase the net present value of the economic profits of the firm</p> <p>i.e. wealth = Present value of benefits – present value of costs.</p>															
Superiority of wealth maximization over profit maximization	<table border="1" data-bbox="474 1333 1451 1866"> <thead> <tr> <th data-bbox="474 1333 714 1386">Basis</th> <th data-bbox="714 1333 1056 1386">Wealth Maximization</th> <th data-bbox="1056 1333 1451 1386">Profit Maximization</th> </tr> </thead> <tbody> <tr> <td data-bbox="474 1386 714 1511">Cash Flows</td> <td data-bbox="714 1386 1056 1511">Consider all cash flows and effect on EPS, dividend, etc.</td> <td data-bbox="1056 1386 1451 1511">Don't consider effect on EPS, dividend, etc.</td> </tr> <tr> <td data-bbox="474 1511 714 1595">Dividend</td> <td data-bbox="714 1511 1056 1595">Firms may pay regular dividends to shareholders.</td> <td data-bbox="1056 1511 1451 1595">Firms may refrain from dividend payments</td> </tr> <tr> <td data-bbox="474 1595 714 1742">Preference by shareholders</td> <td data-bbox="714 1595 1056 1742">Shareholders prefer increase in wealth</td> <td data-bbox="1056 1595 1451 1742">Shareholders may consider increasing profit flow against increase in wealth.</td> </tr> <tr> <td data-bbox="474 1742 714 1866">Ambiguity</td> <td data-bbox="714 1742 1056 1866">No ambiguity in measurement of cash flows</td> <td data-bbox="1056 1742 1451 1866">Lot of ambiguity exists in measurement of accounting profit.</td> </tr> </tbody> </table>	Basis	Wealth Maximization	Profit Maximization	Cash Flows	Consider all cash flows and effect on EPS, dividend, etc.	Don't consider effect on EPS, dividend, etc.	Dividend	Firms may pay regular dividends to shareholders.	Firms may refrain from dividend payments	Preference by shareholders	Shareholders prefer increase in wealth	Shareholders may consider increasing profit flow against increase in wealth.	Ambiguity	No ambiguity in measurement of cash flows	Lot of ambiguity exists in measurement of accounting profit.
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Financial Management Decisions for achievement of wealth maximization	<p>(a) Investment Decision – It relates to the selection of assets in which funds will be invested by a firm. Only that investment proposal is to be accepted which is expected to yield at least so much return as is adequate to meet its cost of financing.</p> <p>(b) Financing Decision - The finance manager has to maintain a proper balance between long-term (capital employed) and short-term funds (working capital). The optimum financing mix will increase return to equity shareholders and thus maximise their wealth.</p> <p>(c) Dividend Decision – Finance Manager assists in deciding as to what portion of the profit should be paid to the shareholders by way of dividends and what portion should be retained in the business. An optimal dividend pay-out ratio maximises shareholders' wealth.</p>
Inter-relationship between investment, financing and dividend decisions	<p>The decision to invest in a new project needs the finance for the investment. The financing decision, in turn, is influenced by and influences dividend decision because retained earnings used in internal financing deprive shareholders of their dividends. The optimal joint decision is possible by evaluating each decision in relation to its effect on the shareholder's wealth.</p>
Risk-Return Trade Off	<p>In financial management, the risk is defined as the variability of expected returns from an investment. Risk and Return go together. The rate of return required by a firm, to a great extent, depends upon the risk involved.</p> <p>A finance manager cannot avoid the risk altogether nor can make a decision by considering the return aspect only. In order to maximise the firm's shares a balance must be maintained between risk and return which is called Risk-Return Trade off.</p>
Functions of finance manager	<p>(a) Estimating the requirement of funds (b) Decision regarding capital structure (c) Investment Decision (d) Dividend Decision (e) Evaluating financial performance (f) Financial negotiation (g) Cash Management</p>
Role of Finance Manager or Chief Financial Officer (CFO)	<ul style="list-style-type: none"> • The traditional role of the finance manager was confined just to raising of funds from a number of sources • The recent development in the socio-economic and political scenario throughout the world has placed him in a central position in the business organization.

	<ul style="list-style-type: none"> He is now responsible for shaping the fortunes of the enterprise, and is involved in the most vital decision of allocation of capital like merger, acquisitions, strategic planning, risk management, pricing analysis, profitability analysis etc.
Agency Problem	<ul style="list-style-type: none"> In modern organization, there is separation of ownership and management. The management acts on behalf of owners and is their agents. Consequently management should act in such a manner so as to maximize wealth of their principals i.e. owners. However this may not happen because owners and management have different interests. Due to these different interest and separation of management from ownership, management may behave in a manner which is inconsistent with the interest of owners. These behavioural problems on the part of management lead to agency problems.
Agency Costs	<ul style="list-style-type: none"> These are the costs that are directed to reduce the impact of agency problems. These costs may be direct or indirect. Example of the direct agency costs are salary, bonuses and perks paid to employees etc. There are also certain indirect agency costs, for example management may not take certain risky projects with high returns.
Financial Distress and Insolvency	<ul style="list-style-type: none"> There are various factors which needs to be managed on continuous basis e.g. price of product, demand, price of inputs, proportion of debt etc. If these are not managed properly than it may lead to financial distress where cash inflows are inadequate to meet current obligations of firm. If financial distress continues for longer time, it may lead to sale assets and may lead to insolvency situation where firm is not able to repay various debts.

Theory Questions

Question – 1

[May18, Nov19]

What are the two main aspects of the Finance Function?

Answer

Value of a firm will depend on various finance functions/decisions. It can be expressed as:

$$V = f(I, F, D)$$

The finance functions are divided into **long term and short-term** functions/decisions

Long term Finance Function Decisions

- (a) **Investment decisions (I):** These decisions relate to the **selection of assets** in which funds will be invested by a firm. **Funds procured** from different sources have to be **invested in various kinds of assets**. Long term funds are used in a project for various **fixed assets** and also for **current assets**.
- (b) **Financing decisions (F):** These decisions relate to **acquiring the optimum finance** to meet **financial objectives** and seeing that fixed and working capital are effectively managed.
- (c) **Dividend decisions(D):** These decisions relate to the determination as to **how much and how frequently cash can be paid out of the profits of an organization** as income for its owners/shareholders. The owner of any profit-making organization looks for **reward** for his **investment in two ways**, the **growth of the capital invested** and the **cash paid out as income**; for a sole trader this income would be termed as drawings and for a limited liability company the term is dividends.

Short-term Finance Decisions/Function

Working capital Management (WCM): Generally **short-term decisions** are reduced to **management of current asset and current liability** (i.e., working capital Management)

Question – 2 [RTP - May19, Nov19, Nov23] [MTP – Nov19, Nov21, May24]

Write note on inter relationship between investment, financing and dividend decision.

Answer

The finance functions are divided into **three major decisions**, viz., **investment, financing and dividend decisions**. It is correct to say that these decisions are **inter-related** because the underlying **objective** of these three decisions is the **same**, i.e., **maximization of shareholders' wealth**. Since investment, financing and dividend decisions are all interrelated, one has to consider the **joint impact** of these decisions **on the market price of the company's shares** and these decisions should also be **solved jointly**. The **decision to invest** in a new project **needs the finance** for the investment. The **financing decision**, in turn, is **influenced by and influences dividend decision** because **retained earnings** used in **internal financing** deprive shareholders of their dividends. An efficient financial management can ensure optimal joint decisions. This is possible by evaluating each decision in relation to its effect on the shareholders' wealth.

The above three decisions are briefly examined below in the light of their inter-relationship and to see how they can help in maximizing the shareholders' wealth i.e., market price of the company's shares.

Investment decision: The investment of long-term funds is made **after a careful assessment** of the various projects **through capital budgeting and uncertainty analysis**. However, only that investment **proposal** is to be accepted which is **expected to yield at least so much return as is adequate to meet its cost of financing**. This has an **influence on the profitability** of the company and ultimately on **its wealth**.

Financing decision: Funds can be raised from various sources. Each source of funds involves different issues. The finance manager has to maintain a **proper balance** between **long-term and short-term funds**. With the total volume of long-term funds, he has to **ensure a proper mix** of loan funds and owner's funds. The optimum **financing mix** will increase return to equity shareholders and thus **maximize their wealth**.



CA

INTERMEDIATE

**AUDITING AND
ETHICS**



- ▶ ICAI Study Material Questions Covered
- ▶ RTP/MTP Questions Covered
- ▶ Past Year Exam Questions Covered

Book recommended by AIR 1

Ankit Mundra

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Chapter wise Distribution (May 2024)		ICAI Weightage
Chapter Number	Marks	Marks
1	3	4 to 6
2	11	8 to 12
3	10	8 to 12
4	11	8 to 12
5	18	12 to 20
6	3	4 to 6
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8	7	8 to 12
9	7	8 to 12
10	4	4 to 6
11	7	8 to 12
Grand Total	88	80 to 122

Nature, Objectives and Scope of Audit

S. No.	Sub Topics	Easy	Moderate	Hard
01.	Introduction			
02.	Origin of Auditing			
03.	Meaning and nature of auditing			
04.	Interdisciplinary nature of auditing			
05.	Objectives of Audit			
06.	Scope of audit			
07.	Scope of audit-What it does not include			
08.	Inherent limitations of audit			
09.	What is an engagement?			
10.	External audit engagements			
11.	Benefits of audit-Why audit is needed?			
12.	Audit- Mandatory or voluntary?			
13.	Who appoints an auditor?			
14.	To Whom report is submitted by an auditor?			
15.	Meaning of Assurance engagement			
16.	Elements of an Assurance Engagement			
17.	Meaning of Review; Audit Vs. Review			
18.	Types of Assurance Engagements			
19.	Qualities of Auditor			
20.	Engagement and Quality control Standards: An Overview			
21.	Standards on Auditing			
22.	Standards on review engagements			
23.	Standards on Assurance engagements			
24.	Standards on Related Services			
25.	Standards on Quality Control			
26.	Why are Standards needed?			
27.	Duties in relation to Engagement and Quality Control Standards			

■ INTRODUCTION

Business Environment→Complex



→ Money Lender→Credit Worthiness



→ Share holders→Financial Position of Co.



→ Bank→Credit Worthy



→ Government → Taxes



→ InsuranceCo.→Settle Claims

RELIANCE ?
CONFIDENCE?

Financial Statements→True & Fair

■ ORIGIN OF AUDITING

Auditing→Ancient Times → Many Societies

Kautilya's Arthashastra →4th Century BC

Focus

- Fixed Accounting Year
- Proces of Closure of A/c.s
- Auditing
- Periodical Checking
- Verification
- Misstatement in F.S
- Abuse of Power

Origin of the word 'Audit' → Latin → Audire → To HEAR

I Auditor General of India → 1860

Accounting

Auditing

Presently → Constitutional Authority

↓

C & AG

ICAI → Statutory Body → Act of Parliament

What do such real-life situations highlight? Such instances underline importance of auditing in today's complex business environment. Be it investors desirous of investing their money in companies, shareholders anxious to know financial position of companies they have invested in, banks or financial institutions willing to lend funds to credit-worthy organizations, governments desirous of collecting taxes from trade and industry in accordance with applicable laws, trade unions negotiating with corporate managements for better wages or insurance companies wanting to settle property claims caused by fire or other disasters- range of diverse users in equally diverse fields rely upon audited financial statements.

Can you figure out reason behind such reliance? It is due to the fact that audited financial statements provide confidence to users of financial statements; audited financial statements provide assurance to users who may take their decisions on the basis of such audited financial statements.

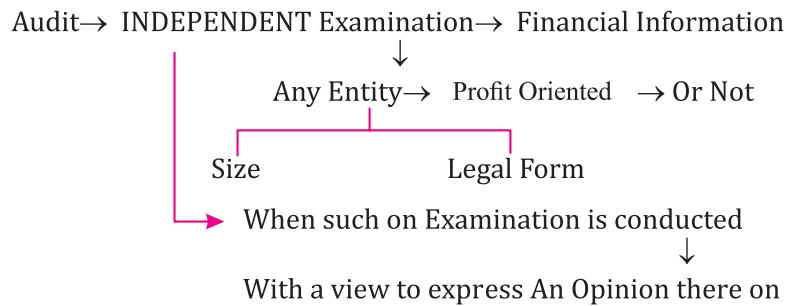
Herein lies the importance of auditing. You can very well understand how significant is role of auditing profession and auditors in modern world involving multitude of economic activities being carried out in equally dynamic legal and regulatory environments.

Here, comes a vital question. What do we mean by auditing? What is its nature and scope? What it includes and What it does not? What are its limitations? We shall try to find out answers to these questions in succeeding paras.

Before we get to understand meaning and nature of auditing, let's travel back in time to know about origin of auditing. Auditing has existed even in ancient times in many societies of world including India. The reference to auditing is found in Kautilya's Arthashastra even in 4th century BC. It talks about fixed accounting year, a process for closure of accounts and audit for the same. Concepts of periodical checking and verification existed even in those times. Even there are references in his monumental work to misstatements in financial statements due to abuse of power. Wasn't he far ahead of his times? The word "audit" originates from Latin word "audire" meaning "to hear". In medieval times, auditors used to hear the accounts read out to them to check that employees were not careless and negligent. Industrial revolution in Europe led to astronomical expansion in volume of trade and consequently demand of auditors. Coming to more recent history, the first Auditor General of India was appointed in British India in 1860 having both accounting and auditing functions. Later on, office of Auditor General was given statutory recognition. Presently, Comptroller and Auditor General of India is an independent constitutional authority responsible for auditing government receipts and expenditures. The Institute of Chartered Accountants of India was established as a statutory body under an Act of Parliament in 1949 for regulating the profession of Chartered Accountancy in the country.

Notes to Add

■ MEANING AND NATURE OF AUDITING



Auditor to Ensure

```

graph TD
    FS[Financial Statement] --> A[Does not mislead]
    FS --> B[As per Books of A/c]
    FS --> C[Amount Properly]
    FS --> D[True + Fair]
    C --> E[Classified]
    C --> F[Described]
    C --> G[Disclosed]
    E, F, G --> H[As per AS]
    Entries[Entries] --> I[Supported by Suff. + Appro. A.E.]
    Entries --> J[Not omitted]
    Information[Information] --> K[Clear]
    Information --> L[Unambiguous]
    Auditing[Auditing] --> Provides[Provides Assurance]
    Provides --> ToUser[To user]
    ToUser --> FS[Financial Statement]
    FS --> Credibility[Credibility]
    FS --> ReliedUpon[Relied Upon]
  
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Notes to Add

QUESTIONS

Theory Questions

1. Explain clearly meaning of Auditing. How would you as an auditor perform the audit.

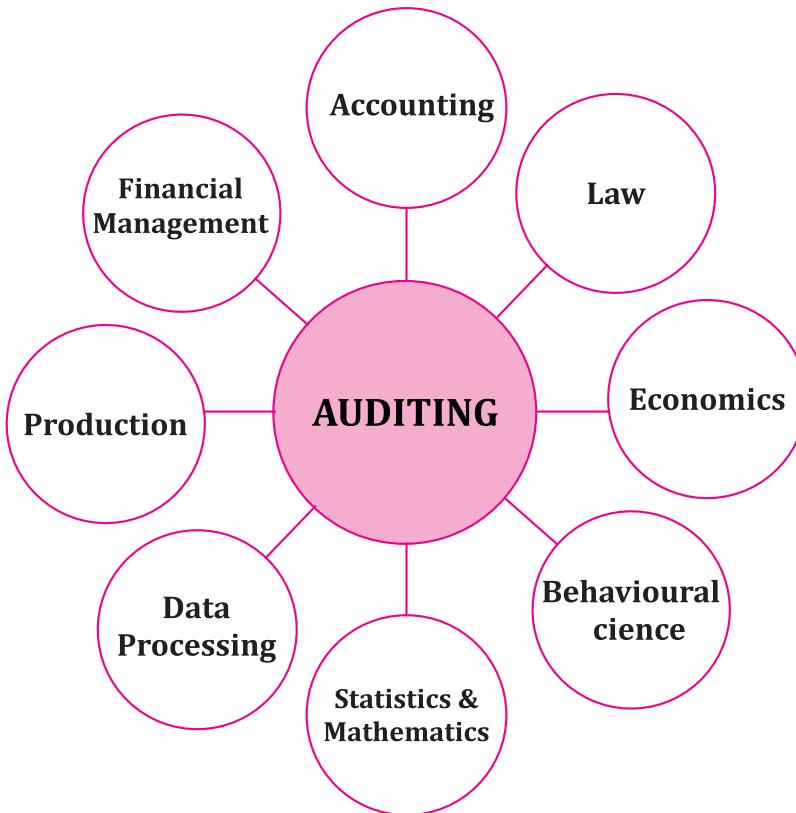
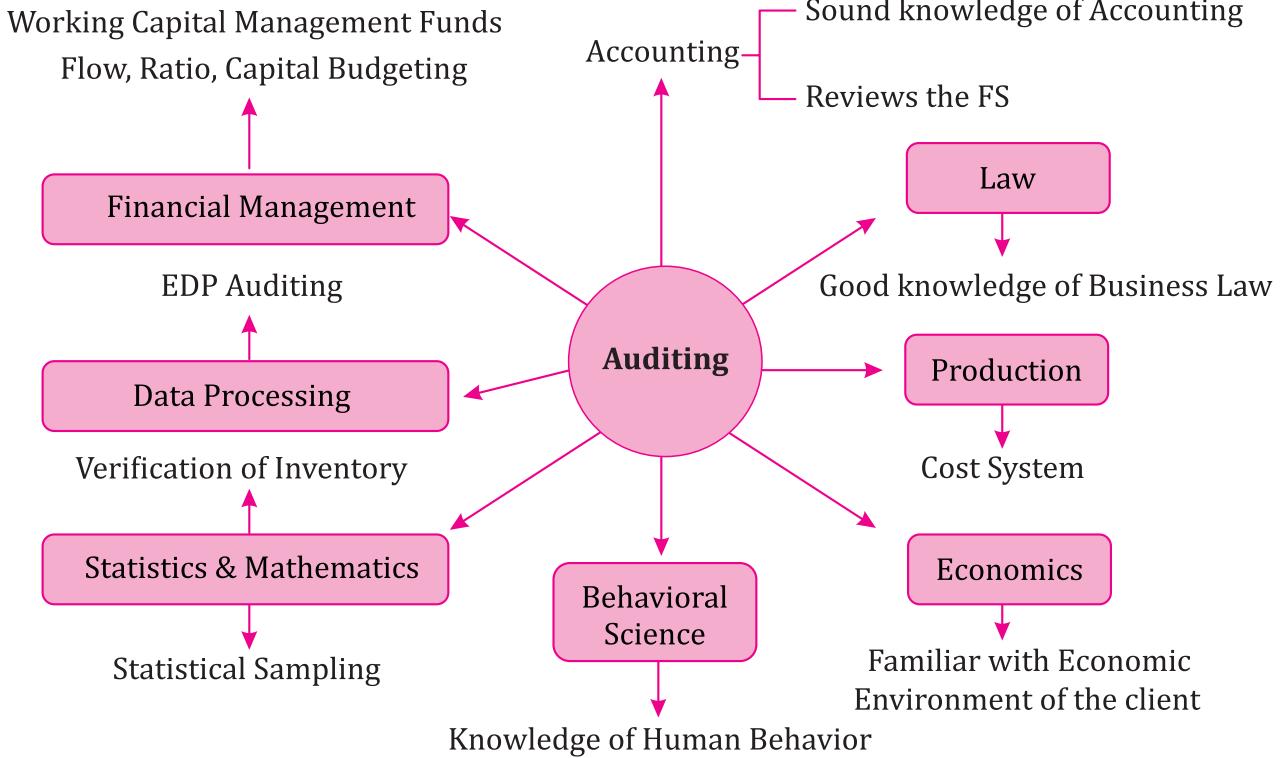
Ans. “An audit is an independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.”

The person conducting this task should take care to ensure that financial statements would not mislead anybody. This he can do honestly by satisfying himself that:

- (i) The accounts have been drawn up with reference to entries in the books of account;
- (ii) The entries in the books of account are adequately supported by sufficient and appropriate evidence;
- (iii) None of the entries in the books of account has been omitted in the process of compilation and nothing which is not in the books of account has found place in the statements;
- (iv) The information conveyed by the statements is clear and unambiguous;
- (v) The financial statement amounts are properly classified, described and disclosed in conformity with accounting standards; and
- (vi) The statement of accounts present a true and fair picture of the operational results and of the assets and liabilities.

Notes to Add

■ INTERDISCIPLINARY NATURE OF AUDITING-RELATIONSHIP WITH DIVERSE SUBJECTS



Correct/Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

- According to Mr. H, one of the team members of the auditor of Very Essential Limited was of the view that no relation exists between accounting and auditing from the point of view of a company.

Ans. Incorrect: The viewpoint of Mr. H is incorrect because there exists a proper relation between accounting and auditing from the point of view of a company. Audit is conducted for financial statements of a company and those financial statements are prepared with the help of books of accounts of that company. In order to properly conduct an audit of a company, an auditor is required to be aware of accounting principles and accounting policies of that company.

- Mr. S, one of the new team members of the auditor of Extremely Effective Limited was of the view that for the purpose of conducting an audit, only knowledge of direct tax is required whereas no knowledge of indirect tax is required.

Ans. Incorrect: The viewpoint of Mr. S is incorrect because for the purpose of conducting an audit, proper knowledge of both direct tax as well as indirect tax is required.

Theory Questions

- "The independent audit of an entity's financial statements is a vital service to investors, trade payables, and other participants in economic exchange". Explain

Ans. Auditing along with other disciplines such as accounting and law, equips you with all the knowledge that is required to enter into auditing as a profession. No business or institution can effectively carry on its activities without the help of proper records and accounts, since transactions take place at different of time with numerous persons and entities. The effect of all transactions has to be recorded and suitably analysed to see the results as regards the business as a whole. Periodical statements of account are drawn up to measure the success of whole. Periodical statements of account are drawn up to measure the success or failure of the activities in achieving the objective of the organization. This would be impossible without a systematic record of transactions. Financial statements are often the basis for decision making by the management and for corrective action so as to even closing down the organization or a part of it. All this would be possible only if the statements are reliable; decisions based on wrong accounting statements may prove very harmful or even fatal to the business. For example, if the business has really earned a profit but because of wrong accounting, the annual accounts show a loss, the proprietor may take the decision to sell the business at a loss. Thus from the point of view of the management itself, authenticity of financial statements is essential. It is more essential for those who have invested their money in the business but cannot take part in its management, for example, shareholders in a company, such persons certainly need an assurance that the annual statements of accounts sent to them are fully reliable. It is auditing which ensures that the accounting statements are authentic. In today's economic environment, information and accountability have assumed a larger role than ever before. As a result, the independent audit of an entity's financial statements is a vital service to investors, trade payable, and other participants in economic exchange.

- Mr. G, one of the team members of audit team of Different and Capable Limited was of the view that role of computers and data processing in auditing is increasing with each passing day. Explain how computers and data processing helps in conducting audit of a company.



INTERMEDIATE

COST AND MANAGEMENT ACCOUNTING



- ▶ ICAI Study Material Questions Covered
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CA INTERMEDIATE

Group-2

सामवाणी MCQs



- Comprehensive Curriculum Coverage with Diverse questions
- Strictly based on ICAI modules
- Covers Theoretical and Practical Questions

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Chapter 1

Introduction to Cost and Management Accounting

MCQs

1. _____ is anything for which a separate measurement is required.
(a) cost unit (b) cost object
(c) cost driver (d) cost centre

2. _____ is a post mortem of past costs.
(a) Financial accounting (b) cost accounting
(c) both a & b (d) none of these

3. Which of the following is true about cost control?
(a) It is a corrective function (b) It challenges the set standards
(c) It ends when targets achieved (d) It is concerned with future

4. In automobile _____ costing is used
(a) Process (b) batch
(c) multiple (d) job

5. _____ costing is applicable to printers.
(a) Process (b) batch
(c) multiple (d) job

6. Which of these is not an objective of Cost Accounting?
(a) Ascertainment of Cost
(b) Determination of Selling Price
(c) Cost Control and Cost reduction
(d) Assisting Shareholders in decision making

7. Cost unit in power sector is:
(a) Kilometer (KM) (b) Kilowatt-hour (kWh)
(c) Number of electric points (d) Number of hours

8. Process costing method is suitable for
(a) Transport sector (b) Chemical industries
(c) Dam construction (d) Furniture making

9. Which of the following is not true about the cost control and cost reduction:
(a) Cost control seeks to attain lowest possible cost under best conditions
(b) Cost control emphasis on past and present
(c) Cost reduction is a corrective function. It operates even when an efficient cost control system exists
(d) Cost control ends when targets are achieved

10. The advantages of using IT in Cost Accounting does not include:
(a) Integration of various functions
(b) Stock needs to be reconciled with goods received note
(c) Reduction in multicity of documents
(d) Customized reports can be prepared

11. A taxi provider charges minimum ₹80 thereafter ₹12 per kilometer of distance travelled, the behavior of conveyance cost is:
(a) Fixed cost (b) Semi-variable cost
(c) Variable cost (d) Administrative cost

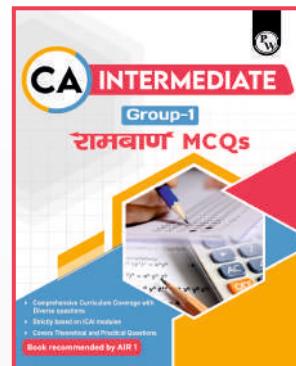
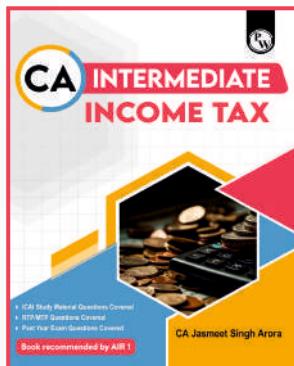
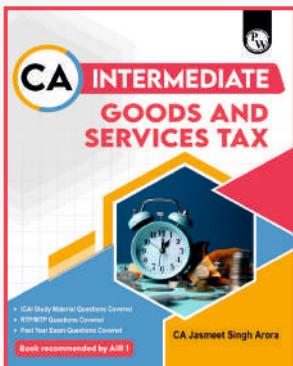
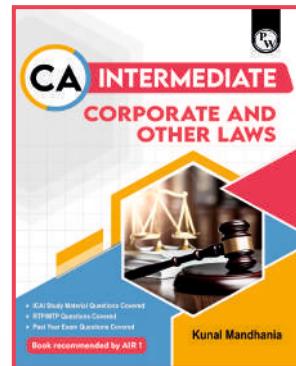
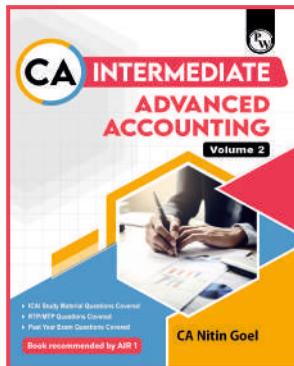
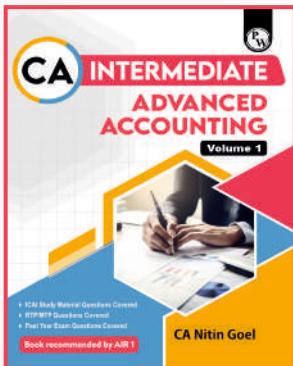
12. SK Ltd. has three production department, each department has two machines, which of the following cannot be treated as a cost centre for cost allocation:
(a) Machines under the production department (b) Production departments
(c) Both production department and machines (d) SK Ltd.

13. _____ costing is used in transport undertakings.
(a) Process (b) service
(c) multiple (d) job

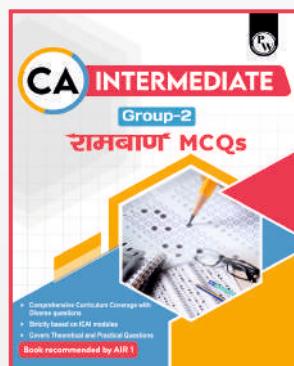
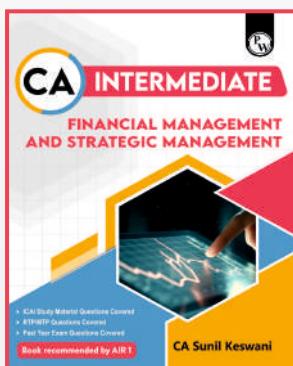
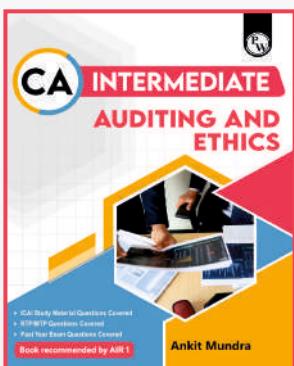
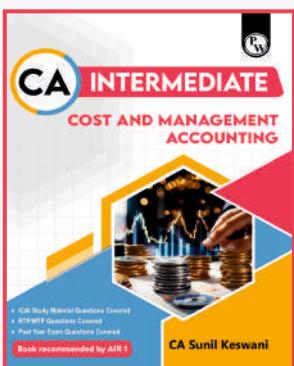
14. The total variable cost _____ in total proportion to output.
(a) Increases (b) does not increase
(c) decreases (d) none of these-

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