

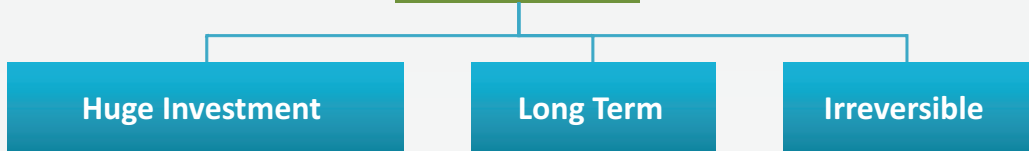


Capital Budgeting



Revenue Budget	Capital Budget
Prepared for one year	Prepared for long term
Contains only revenue items	Contains both revenue & capital items
Prepared to set goals for next one year	Prepared to take long term investment decision

Important because



Types of Proposals

Mutually Exclusive

एक select होने पर बाकी सब अपने आप reject हो जाएंगे

Independent

जो भी cut off को cross कर जाएगा वो select हो जाएगा it means सारे भी select या reject हो सकते हैं

Evaluation Methods

- Payback Period
- Discounted Payback Period
- Payback Reciprocal
- Net Present Value (NPV)
- Internal Rate of Return (IRR)
- Profitability Index (PI)
- Accounting Rate of Return (ARR)

Calculation of Annual Cash flows

Method 1: This methods is preferable when both inflows and outflows are give in the question. If only outflows are given then “Method-2” is preferable.

Particulars	Amount	
Cash Income (Sales)	2,00,000	Cash Income means <ul style="list-style-type: none"> • Sales or • any Saving in expenses. Cash expense may be in the form of <ul style="list-style-type: none"> • variable and fixed cost or • Raw material, wages, cash overhead or • repairs, maintenance or • any other revenue expenditure. PAT = PBT (1-t)
Cash Expenses	1,10,000	
Cash Flows before Tax	90,000	
Depreciation	30,000	
Profit Before Tax	60,000	
Tax @30%	18,000	
Profit After Tax	42,000	
Depreciation	30,000	
Cash Flow After Tax	72,000	

Method 2: This is shorter then first method and also suitable to situation when only outflows are given

$$CFAT = \text{Cash income} (1-t) - \text{Cash Expenses} (1-t) + \text{Depreciation} \times t$$

Situation 1: If Sales, Variable Cost, Fixed Cost and Depreciation are given:

$$CFAT = \text{Sales} (1-t) - \text{Variable Cost} (1-t) - \text{Fixed Cost} (1-t) + \text{Depreciation} \times t$$

$$= 2,00,000 \times 0.7 - 1,10,000 \times 0.7 + 30,000 \times 0.3$$

$$= 1,40,000 - 77,000 + 9000 = 72,000$$

Situation 2: If Saving in wages, Maintenance and Depreciation are given:

$$CFAT = \text{Saving in wages} (1-t) - \text{Maintenance} (1-t) + \text{Depreciation} \times t$$

Situation 3: If only Repairs and Depreciation are given:

$$CFAT = - \text{Repairs} (1-t) + \text{Depreciation} \times t$$

Situation 4: If CFBT and Depreciation are given:

$$CFAT = \text{CFBT} (1-t) + \text{Depreciation} \times t$$

$$= 90,000 \times 0.7 + 30,000 \times 0.3 = 63,000 + 9,000 = 72,000$$

Treatment of loss

If profit before tax is negative	
Question is silent or Question says that the company has other profitable business activities	Set-off loss and consider inflow of tax benefit in the same year
Question says that the company does not have any other profitable business activities	carry forward loss in next year(s) and deduct it from profit of that year

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