CHAPTER EIGHT

FINANCIAL MANAGEMENT

Financial management is an integral and inextricable component of management of an enterprise rather than a staff speciality concerned with fund raising operations. There is an increasing realisation about the importance of wise usage of funds. The long-held concept that the finance function is concerned with 'keeping the business supplied with enough funds to accomplish its objectives' is under change. True, the obtaining of required amount of funds at appropriate time and on the most favourable terms still constitutes the core of financial management, but due to the operation of array of factors such as competition, technology, Government's fiscal and monetary policies which has made availability of finance scarce (the problem being more acute in developing countries like Nepal where saving capacity of the people is meagre), the prudent and judicious utilisation of these funds has assumed greater importance. Thus, the finance function is not just the supply of funds to the business, rather it is vitally concerned with the effective deployment of funds.


Sound financial management envelopes three inevitable and inescapable tasks each beginning with the letter 'A'. These three 'As' are: (a) anticipating financial needs, (b) acquiring financial resources, (c) allocating funds in the business. An efficient and prudent financial manager must handle these three A's properly. Said simply, financial management is intimately concerned with planning, preparations, financing, budgeting, accounts, internal and external audit, and so on. It touches practically every facet of an enterprise management. Since the managerial efficiency of an enterprise is most succinctly and discernibly reflected in its financial statements, managers at all levels must, therefore, concern themselves with the present and future financial implications of their decisions and actions. The emphasis has to be placed on obtaining specific results with the minimum of inputs rather than on achieving targets of expenditure.

8.1 Place of finance function in AIC

8.1.1 Organisational set up of finance department occupies an important niche in the financing management of an enterprise. The division and distribution of work among various employees need to be clearly defined; and the working procedures and job responsibilities of each should be spelt out in black and white. The reporting system must ensure that the flow of information is suitably channelised. Moreover, the


finance department should have an easy and unrestricted approach to the top management for all financial matters.

There are two separate departments to handle financial aspects of the Corporation. While one is engaged in routine financial transactions, the other undertakes the auditing aspect of the transactions. The organisation chart of AIC (Chart 2.1) as displayed earlier in chapter 2 has shown that both the departmental heads have equal status in the organizational hierarchy of the Corporation and they also have the same status as other departmental heads. But they do not have equal access to the top management (Chief Executive) as in the organizational design of the Corporation finance department is placed under the Deputy General Manager and the internal audit department is slotted under the General Manager. Organization structure of finance division (Chart 8.1) reveals that there are 8 officers in the division including division chief. The chief is assisted by two senior officers - one is designated as deputy division chief and the other as senior officer. While the deputy division chief has 3 officers reporting to him each one of them looking after central accounting, settlement of coupons with Agricultural Development Bank, and financial reporting respectively. The other senior officer is assisted by two officers - one handles the payments and the other one looks after stock accounts of the Corporation.

5. Status is measured here in terms of salary and level of position of departmental heads.
CHART 8-1 ORGANIZATION STRUCTURE OF FINANCE DIVISION

LEVEL OF POSITION | SCALE  |
------------------|--------|
10                | 1275 - 1625 |
9                 | 950 - 1300  |
8                 | 800 - 1240  |
7                 | 700 - 1025  |
5                 | 450 - 755   |
4                 | 330 - 590   |
3                 | 255 - 457.50|
1                 | 150 - 252   |

DIVISION CHIEF

DEPUTY DIVISION CHIEF

OFFICER PAYMENT

OFFICER STOCK

OFFICER ACCOUNT

OFFICER REPORT

OFFICER COUPON

SENIOR ASSISTANT

SENIOR ASSISTANT

SENIOR ASSISTANT

SENIOR ASSISTANT

ASSISTANT

ASSISTANT

TYPIST

TYPIST

JR. ASSISTANT

PEON

SOURCE - AIC COURSEY

SCALE

LEVEL OF POSITION

SOURCE — AIC COURSEY
8.1.2 Involvement in decision making

Decision making, today is the central focus of finance function. The earlier emphasis on detailed analysis of operating procedures has now been shifted to the formulation of rational decisions based on the optimal use and allocation of funds. An integrated approach in financial decision making involves formulating capital budgets, long range plans, alternative use of funds and periodical evaluation of progress and performance of an enterprise. The active participation of finance department in planning and programming is of crucial importance because plans are based on financial informations. But in AIC finance department has not much say in financial planning and policy formulation. As stated earlier in chapter 4, the planning and programming of the Corporation including financial budgeting are prepared by planning and evaluation division of the Corporation. The finance department of the Corporation has not been fully involved in financial planning. Although from the job description of finance department, it is expected to be proactive in the financial matter but in practice it has not been so. Performance budgets, cash flow and fund flow statements, which are considered essential tools of financial management, have never been prepared. Financial reporting system of the Corporation is poor. During the last 15 years of its existence the Corporation has not published its balance sheet for public consumption.
8.1.3 Delegation of authority

Delegation of authority has been an essential ingredient for efficient working of every functional area of management. In AIC however, the delegation of authority to finance chief is very limited. In financial matters it is confined only to day-to-day routine transactions. The head of finance department is authorised to sanction certain expenditure to a limited amount specified by the chief executive order, but it has not been sufficient so as to enable him to discharge effectively the responsibilities devolved on his shoulders. While the extent of delegation will vary from enterprise to enterprise and even from department to department depending upon the pattern of working of the individual enterprise and department, the need for delegation of sufficient authority has to be recognized by all concerned. Unless the process of delegation is carried down to the line very much below the level of head of department, the officers in the Corporation are likely to lose morale and would not have the sense of involvement which they should; they would gradually become more and more ineffective.

8.2 Financing Capital Requirement

Public enterprises in Nepal are generally run with major equity capital participation of the Government. The Government also assumes direct responsibility to arrange required capital from other sources such as banks to these enterprises. However, there has not been a clear policy of the Government in this regard. For public enterprises established under the Corporation Act there is no provision
for the issue of share capital as in the Company Act. In such cases the Government annually supplies capital in the form of financial investment. Such financial investments are usually allocated in the Government's annual budget. While making allocation for AAIC in its annual budget the Government generally specifies the purpose for which the funds are to be used. Upto the Mid-July 1976 the accumulated balance of the funds in the accounts of the Corporation stood at Rs 31.9 million. These amounts also included foreign aid received under various schemes such as German grant, US aid, a substantial portion of which were to be used for constructing godowns. For financing the purchases of INPUTS the Corporation has been banking upon bank-borrowings.

Initially, the Corporation used to borrow money from the then Land Reform Saving Corporation. Now the Corporation's major source of finance has been borrowings from Agricultural Development Bank. Besides, the Corporation also borrows from other commercial banks. All these borrowings are guaranteed by the Government. There is no special concession with regard to interest rate. The Corporation has to pay normal interest to its bankers. Each year a substantial amount is forked out as interest. For example, in the borrowings of 1974-75 alone the Corporation had to pay more than Rs 13.5 million as interest in one year. The total amount of interest paid to the bankers has been gradually increasing as the Corporation's volume of business has been increasing.
There is no fixed proportion between owned and loaned capital. Since neither the Corporation's authorised capital has been decided nor the Government has adopted a definite policy regarding the financing of capital requirement of the Corporation, every increased volume of business has to be financed through borrowings. Consequently the ratio between owned capital and loan fluctuated from year to year. Upto 1972-73 loan amount of the Corporation was less than the owned fund, but thereafter the loan amount had started exceeding owned capital. In 1973-74 loan was 13 percent more than the owned capital while in 1974-75 loan amount (Rs 96.4 million) was five times of the owned capital (Rs 18.3 million). When the amount payable to the supplier, the amount payable for fertilizers received from the donor agency and other provisions are also included in the loan amount, an altogether different picture emerges (Table 8.1)

Table 8.1: Corporation's owned fund and other liabilities during 1967-68 to 1975-76

<table>
<thead>
<tr>
<th>Years</th>
<th>Owned fund in '000 ₹</th>
<th>Other liabilities in '000 ₹</th>
<th>Owned fund as a percentage of other liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1967-68</td>
<td>8222</td>
<td>5189</td>
<td>158</td>
</tr>
<tr>
<td>1968-69</td>
<td>10563</td>
<td>4956</td>
<td>213</td>
</tr>
<tr>
<td>1969-70</td>
<td>12623</td>
<td>6336</td>
<td>199</td>
</tr>
<tr>
<td>1970-71</td>
<td>14664</td>
<td>11346</td>
<td>129</td>
</tr>
<tr>
<td>1971-72</td>
<td>14056</td>
<td>14616</td>
<td>96</td>
</tr>
<tr>
<td>1972-73</td>
<td>26310</td>
<td>69960</td>
<td>38</td>
</tr>
<tr>
<td>1973-74</td>
<td>28960</td>
<td>81940</td>
<td>35</td>
</tr>
<tr>
<td>1974-75</td>
<td>18336</td>
<td>179703</td>
<td>10</td>
</tr>
<tr>
<td>1975-76</td>
<td>32081</td>
<td>137211</td>
<td>23</td>
</tr>
</tbody>
</table>

Source: AIC

Note: a) Owned fund includes the amount received from the Government, either from its own or through foreign aid, and undistributed profit amount.

b) Other liabilities include loan from the bank, the amount payable to the supplier, the amount payable for fertilizers received from donor agency, and other provisions.
The data on the Table reveals that upto 1970-71 the Corporation's owned fund was always more than the amount of other liabilities. Owned fund as a percentage of other liabilities ranged from 129 percent (1970-71) to 213 percent (1968-69). From 1971-72 onwards the proportion of owned fund started declining. The Corporation was in its most vulnerable financial position in 1974-75 when its owned fund constituted only 10 percent of other liabilities.

These empirical evidences clearly indicate that proper heed has not been paid towards designing a sound capital structure for the Corporation. A well thought-out decision on equity-loan-mix in the capital structure would have a far reaching implications. The decision in this regard should be taken only after a thorough consideration of many factors such as money, market conditions, cash flows, earning capacity etc. In the Corporation, however, the decision with respect to the capital structure is the prerogative of the Government which has never considered the long-term implications of its decision. At the most the Government has usually been pleading for uniformity among public enterprises without considering the special requirements of a particular enterprise.

The owned fund has a solid advantage in the sense that there is no legal obligation to provide for a return on the amount. In an enterprise like AIC which has to spend a substantial amount for constructing godowns and whose profitability is negative, the borrowed fund has severe effects. The Corporation is running at loss, upto 1977. The Corporation had
eaten away all its owned capital as the accumulated losses were 85 million as against only 32 million owned capital. On the one hand, it is not in a position to repay its outstanding loan at its own, on the other hand it has to resort to continuous borrowing for financing future purchases. Under the circumstances further weakening of the liquidity position of the Corporation cannot be ruled out.

One of the reasons for such a state of affairs is the absence of adequate equity capital at the disposal of the Corporation. The other equally important reason is the price subsidy policy of the Government. As stated earlier the Government has final say in pricing decision of the Corporation and the prices of certain fertilizers are being kept purposely below the landed cost. At the moment the Government is not providing to the Corporation the amount equivalent to the difference in landed cost and selling price. As a result of this too the financial position of the Corporation has been on the worsening.

8.3 Budgeting

As in most public enterprises in Nepal AIC also follows a traditional pattern of budgetary forms and procedure. The system in vogue for classifying expenditure in the budgets does not link estimated expenditure to proposed activities and end results. Such linkages are necessary conditions for adopting the technique of performance budgeting. Besides, the budgetary exercises also lack detailed workout with the result they do not serve any useful purpose for management decisions; at the
most they are used as a base for obtaining funds and as an instrument of controlling expenditure levels. Thus the preparing Corporation is not at the moment a comprehensive business type budget.

A budget in its true sense is a plan and programme of action - an integral part of management dynamics which enables the members of the enterprise to make use of resources, and to project their idea into the future, and concurrently to look back and review the actual performance as compared with promise and intentions. Viewed in this perspective a budget is not merely an instrument of expenditure control. If it is used only for control purposes it is divested of much of its utility because it will encourage a tendency to budget more than anticipated expenditure and less than expected performance resulting into figures of performance that show an improvement but an unreal and distorted painting of the facts.

For a trading enterprise like AIC a comprehensive budget should include not only financial aspects but also non-financial facets and cover the whole organization and all phases of its operation for a specified future period. The budgeting activities should include: sales estimates, procurement estimates, cost of procurement, human resource budget, construction budget, profit and loss estimates, cash flow estimates etc. In order to make budgets a meaningful tool for management decisions these should be suitably grouped under three heads such as revenue budgets, capital expenditure budgets and cash budgets.

In addition to being a prognostication of income and expenditure, the revenue budgets should be considered as a plan and a base for the policy formulation and for jotting down the performance standard expected within a specified time period. It should be reviewed periodically and corrective measures should be adopted for variations. In AIC revenue budgets are prepared but it includes only expenditure aspects. A separate forecast is done for sales in physical quantity but the expected revenue from the estimated sales are not done. Thus financial planning in its true sense is not attempted. Estimation of expenditure in the Corporation involves basically a two-fold process - the upward submission of estimates and the downwards transmission of provisions decided upon at authorised higher level. In the process it is also submitted to the Government for its prior approval.

Capital budget is also required in every enterprise which provides a framework within which additional schemes can be planned and approved by the Government. In AIC construction of storehouses constitutes the major schemes under capital budget. The capacity of the storehouses and the estimated expenditure therein are discussed with the Government. The agreed amount is shown in the national plan and the same is reflected in the Corporation's annual target. But the experience with utilisation of the capital expenditure budget is that efforts are not made to ensure that the schemes get started as planned and once started, schemes are consummated with the minimum delay. It has been found that generally construction of storehouses are approved by the Government keeping in view the prospects of
foreign aid. In some cases the delays in reaching an agreement with the donor agency have also been responsible for delays in the start of the work with the result the projects are seldom completed in time. Moreover, with the passage of time the estimated cost is also increased and the Corporation finds it difficult to complete the project within the funds available. Another problem is the unavailability of construction material. At the time of planning for construction—the availability of construction materials is planned in normal way. However, in reality, this is not so. There are several instances where scarcity of construction materials, have also delayed the completion of the project.

The working of the budgetary system depends upon the availability of funds in time. In this respect cash budget constitutes an integral part of the whole budgetary system as it provides the means of planning, forecasting and keeping check on the funds that are available for making payments towards revenue or capital transactions. By preparing a cash budget the Corporation can know in advance the net effects of all receipts and payments and can also ensure the availability of sufficient cash to settle the amounts as and when they fall due without ignoring the opportunity cost of the idle cash balance. In spite of such advantages the Corporation does not prepare a cash budget.

8.4 Internal auditing

Internal auditing, as it is now coming to be called as operational audit, is one of the essential facets of financial
management system of any enterprise. It is basically a tool of financial control and provides service to the management. In its broadest sense, internal auditing refers to the regular and independent appraisal of the accounting, financial and other operations of any enterprise by its internal auditors. Though the use of the term is usually limited to the auditing of its accounts, the concept to be really useful would imply appraisal of operations, guaging actual results in the light of planned results. Herein, internal auditors in addition to ensuring that accounts are 'correct and true' with reference to the established policy and procedures, also appraise policies, procedures, use of authority, quality of management, effectiveness of methods, special problems and other phases of operations. In a country-wide spread organization like AIC the degree of control that can be exercised by the officer incharge of finance function is limited. In this context the need for internal audit becomes quite obvious.

In the Corporation, as stated earlier, a separate division has been created at head office to perform internal auditing of the financial transactions made at head office as well as at all field offices. The personnel of the division are assigned specific geographic area of their operations. There are 4 groups of people who look after each of the 4 development regions of the country (chart 8.2). The activities of these groups are co-ordinated by the division chief and his deputy. The task assigned to the internal auditors mainly involves reviewing accounting, financial and other procedures
CHART 8-2 ORGANIZATION STRUCTURE OF INTERNAL AUDIT DIVISION

<table>
<thead>
<tr>
<th>LEVEL OF POSITION</th>
<th>SCALE</th>
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<tbody>
<tr>
<td>10</td>
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<td>3</td>
<td>255 - 457.50</td>
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<tr>
<td></td>
<td>150 - 252</td>
</tr>
</tbody>
</table>

- DEPUTY DIVISION CHIEF
- DIVISION CHIEF
- OFFICER ACCOUNT
- SENIOR ASSISTANT
- SENIOR ASSISTANT
- SENIOR ASSISTANT
- SENIOR ASSISTANT
- SENIOR ASSISTANT
- ASSISTANT
- ASSISTANT
- ASSISTANT
- ASSISTANT
- ASSISTANT
- TYPIST
- PEON

AUDITOR CENTRAL REGION
AUDITOR EASTERN REGION
AUDITOR WESTERN REGION
AUDITOR FAR WESTERN REGION
AUDITOR CLAIMS
and the observance of rules and procedures by the finance
division of head office and field offices, ensuring against
fraud and mistakes, and also ensuring simplicity and efficiency
in procedure. Besides, the internal audit division of the
Corporation also handles the activities relating to realization
of dues; a separate officer in the division looks after this
task.

8.5 **Diagnosing financial health**

It is thus obvious that financial management in its
real sense of the term is conspicuous by its absence in the
Corporation. There has been no definite policy regarding
equity-loan-mix in the Capital structure of the Corporation.
The existing equity capital is not adequate and the Corporation
has to bank upon borrowings for meeting its capital requirement.
Price policy of the Government has resulted into heavy losses
to the Corporation which has further worsened the financial
position of the Corporation. Essential tools of financial
management such as performance budgets, fund flow and cash flow
statements which have never been prepared need to be introduced.

The task of internal audit division should be broadened.
There is no persuasive reason as to why the task of internal
auditor cannot be extended to canvas the appraisal of quality
of management, effectiveness of methods, special problems etc.
which have so far remained out of the province of internal
auditor of the Corporation.