

BSBFIM601

Manage finances

Release 1

Learner guide

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Aspire Version 1.2

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Release 1, version 1.1	April 2017	First release
Release 1, version 1.2	October 2019	Broken URLs fixed and updated to Rebrandly links.

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Level 1, 464 St Kilda Road
MELBOURNE VIC 3004 AUSTRALIA
Phone: (03) 9820 1300

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Contact details

Participant
Name:
Start date:
Phone number:
Email:
Work location
Name:
Address:
Postal address:
Workplace supervisor name:
Phone number:
Fax:
Email:
Registered Training Organisation (RTO)
Name:
Address:
Postal address (if different):
Phone number:
Fax:
RTO contact name:
Mobile:
Email:

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Before you begin

This learner guide is based on the unit of competency *BSBFIM601 Manage finances*, Release 1. Your trainer or training organisation must give you information about this unit of competency as part of your training program. You can access the unit of competency and assessment requirements at: www.training.gov.au.

How to work through this learner guide

This learner guide contains a number of features that will assist you in your learning. Your trainer will advise which parts of the learner guide you need to read, and which practice tasks and learning checkpoints you need to complete. The features of this learner guide are detailed in the following table.

Feature of the learner guide	How you can use each feature
Learning content	Read each topic in this learner guide. If you come across content that is confusing, make a note and discuss it with your trainer. Your trainer is in the best position to offer assistance. It is very important that you take on some of the responsibility for the learning you will undertake.
Examples and case studies	Examples of completed documents that may be used in a workplace are included in this learner guide. You can use these examples as models to help you complete practice tasks and learning checkpoints. Case studies highlight learning points and provide realistic examples of workplace situations.
Practice tasks	Practice tasks give you the opportunity to put your skills and knowledge into action. Your trainer will tell you which practice tasks to complete.
Video clips	Where QR codes appear, learners can use smartphones and other devices to access video clips relating to the content. For information about how to download a QR reader app or accessing video on your device, please visit our website: www.aspirelr.com.au/help
Summary	Key learning points are provided at the end of each topic.
Learning checkpoints	There is a learning checkpoint at the end of each topic. Your trainer will tell you which learning checkpoints to complete. These checkpoints give you an opportunity to check your progress and apply the skills and knowledge you have learnt.



Foundation skills

As you complete learning using this guide, you will be developing the foundation skills relevant for this unit. Foundation skills are the language, literacy and numeracy (LLN) skills and the employability skills required for participation in modern workplaces and contemporary life.

The following table outlines specific foundation skills noted for your learning in this learner guide.

Foundation skill area	Foundation skill description
Reading	<ul style="list-style-type: none"> • Interprets, analyses and evaluates complex information to determine and adhere to organisational or legislative requirements and to assist with financial decision making
Writing	<ul style="list-style-type: none"> • Develops and records information which incorporates a detailed analysis of factual and forecasted information • Prepares documents using format, content and layout appropriate to audience, purpose and regulatory requirements
Oral communication	<ul style="list-style-type: none"> • Explains financial decisions and outcomes clearly and uses listening and questioning techniques to exchange information and obtain agreement
Numeracy	<ul style="list-style-type: none"> • Reviews and analyses numerical data embedded in organisational documentation and legislation • Compares and contrasts complex numerical data to analyse and evaluate financial position and processes • Uses appropriate formulae to analyse financial data to assess and manage risk and identify discrepancies
Navigate the world of work	<ul style="list-style-type: none"> • Recognises, understands and adheres to legislative and organisational requirements in undertaking own work
Interact with others	<ul style="list-style-type: none"> • Selects and uses appropriate conventions and protocols when communicating with supervisors and managers to share information or seek agreement
Get the work done	<ul style="list-style-type: none"> • Uses logical processes in planning, implementing and evaluating complex tasks to achieve stated goals • Uses formal analytical thinking techniques to identify issues, investigate underlying causes and generate possible solutions, seeking input from others as required • Uses a range of digital technology to access, filter, compile, integrate and logically present complex information from multiple sources • Investigates new digital technologies and applications to manage and manipulate data

What do you already know?

Use the following table to identify what you may already know. This may assist you to work out what to focus on in your learning.

Topic	Key outcome	Rate your confidence in each section
Topic 1 Plan for financial management	1A Identify accounting principles and standards	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	1B Determine areas of profit and loss	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	1C Determine required resources for organisational strategy implementation	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	1D Review statutory requirements and taxation liabilities	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
Topic 2 Establish budgets and allocate funds	2A Set budgets and allocate financial resources	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	2B Prepare the cash budget	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	2C Prepare the profit and loss and balance sheet budgets	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	2D Develop risk and contingency plans	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
Topic 3 Implement budgets	3A Circulate budgets to managers and supervisors	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	3B Implement controls to minimise risk of improper financial behaviour	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	3C Determine budget variances and manage contingencies	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident

continued ...

... continued

Topic	Key outcome	Rate your confidence in each section
Topic 4 Report on finances	4A Ensure reporting conforms to requirements	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	4B Prioritise significant issues and prepare recommendations	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	4C Evaluate the effectiveness of financial management processes	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident

Topic 1

Plan for financial management

Financial management refers to the planning, directing and controlling of the organisation's monetary resources to achieve organisational objectives. There are four key elements to the financial management process: planning for financial management; budgeting and resource allocation; resource control through budget implementation and control; and financial reporting to ensure effective organisational decision-making.

In this topic you will learn how to:

- 1A Identify accounting principles and standards
- 1B Determine areas of profit and loss
- 1C Determine required resources for organisational strategy implementation
- 1D Review statutory requirements and taxation liabilities

1A

Identify accounting principles and standards

The purpose of financial management is to ensure funds are available for the activities an organisation needs to perform to meet business objectives. Funds need to be available at the right time for the organisation to pay for materials, staff, outsourced services and other operating costs.

Having an understanding of financial management requires knowledge of the relationship between financial management and accounting, accounting principles – including the qualitative characteristics of financial statements and reports – and accounting standards.



Financial management and accounting

The management of an organisation's financial resources is a critical aspect of accounting. The accounting process involves the classification, recording, reporting, analysis and interpretation of financial data, which is the results of financial transactions, to meet the information requirements of internal and external users. Internal users, such as managers and directors, require information for organisational decision-making. This form of accounting is known as management accounting. External users, such as government departments, require the information to ensure the organisation is meeting statutory requirements. Other examples of external users are current and potential shareholders, which are concerned with their investment, and financial institutions, which will use the information to make decisions on lending money for investment. This is typically referred to as financial accounting.

Accounting system key terms

When using accounting systems, you must be able to interpret key terms that relate to the management of organisational finances. The following are classifications used in an organisation's accounting system, or their chart of accounts. Generally, the chart of accounts is a classification system where all financial transactions are categorised within two areas of the organisation's accounting records. These are known as balance sheet items, which include assets and liabilities, and profit and loss items, which include revenues and expenses.

Here are descriptions of the main chart of accounts categories.

Assets

Assets are what an organisation owns and can include land, buildings, vehicles, plant, equipment, goods held in stock, monies owed to it (accounts receivable) and any cash in the bank. An annual stocktake of assets and their condition is essential and will usually be divided into two categories:

- current assets – assets whose future economic benefits will be consumed by the organisation within the current accounting period (usually 12 months)
- non-current or fixed assets – assets whose future economic benefits will extend beyond the current accounting period.

Liabilities

Liabilities represent financial sacrifices of future economic benefits such as the payment of monies to creditors and obligations to other parties such as the Australian Taxation Office (ATO). Most financial liabilities represent a legal obligation that the organisation has to another and can arise due to a past transaction or event such as a business loan. They are usually divided into two categories:

- current liabilities – liabilities due for settlement within the current accounting period (usually 12 months)
- non-current liabilities – liabilities due for settlement beyond the current accounting period.

Owner's equity

Owner's equity represents the owner's investment in the business and is a liability. Sometimes referred to as proprietorship or net worth, this equity is the proportion of assets owned by the owner rather than by creditors or lending institutions.

Owner's equity depends on the funds or capital contribution added by the owner to the business, and profit made is added to the equity. When an owner draws cash and inventory from the business, or the business makes a loss, the owner's equity decreases.

Revenues

The terms revenue and income are used interchangeably and refer to the earnings or proceeds from business activities. This can include:

- sales from services or products, known as inventory
- delivery fee income
- commissions from selling another organisation's products or services
- discounts received
- rent received from properties owned or sublet
- interest earned from investments such as deposits with financial institutions.

Expenses

Expenses are the costs incurred in developing, producing and selling products and services. Expenses include fixed and variable costs. Fixed costs usually remain the same regardless of activity or output, such as the wages associated with a senior manager or the rent of office or manufacturing facilities. Fixed costs generally only change as a result of price increases.

Variable costs are those that are directly related to the level of an activity or output volume. For example, if the organisation increases production, then the costs of direct materials and labour will also increase.

Data and source documents

Data for the organisation's financial transactions is gathered from source documents. When a financial transaction occurs, the document that captures the details of the transaction is called the source document. Every financial transaction has a source document that records details such as the date, amount and purpose of the transaction. Examples include invoices, receipts and credit notes.

The process of managing financial data involves gathering these source documents and ensuring they meet requirements and are classified, coded and recorded correctly in the organisation's accounting system. Source documents of all the organisation's financial transactions represent the initial inputs into the organisation's accounting process so that, eventually, financial reports summarising this information can be produced and given to people to support their decision-making. Source documents also provide an audit trail should the organisation ever need to prove or clarify the details of a particular financial transaction.



Accounting principles

The framework for preparing financial statements, known as the generally accepted accounting principles (GAAP), consists of basic accounting principles (sometimes referred to as conventions and doctrines) and Standards issued by the Australian Accounting Standards Board (AASB).

The following describes the accounting principles, or conventions and doctrines, that govern the way an organisation manages its finances and how it prepares financial reports and statements.

Business entity

For accounting purposes, the business must be a separate entity from its owner/s. The organisation's financial information is treated separately from the owner's personal financial information. The bank accounts for the organisation should also be kept separate from the owner's private accounts.

Accrual accounting and the reporting period

The reporting period is a critical element of accrual accounting – the practice for most organisations – which requires that income earned and expenses incurred in one period (usually 12 months) be recognised within that period.

Conservatism or prudence

The purpose of conservatism or prudence is to ensure revenue and assets are not overstated, and that liabilities and costs are not understated, to ensure responsible accounting practices. For example, increases in an asset's value should only be recognised when the asset is sold (or used) and not before. Decreases in an asset's value (or an increase in a liability) should be recognised immediately.

Historical cost

Using the historical cost means that all financial transactions are recorded at their original value; items are shown in the accounting records at their historical (original) price. Organisations should value assets and liabilities at their historical cost rather than at their current market value. This is designed to support the principle of conservatism to provide reliable accounting information.

Ongoing concern or continuity

For accounting purposes, it is always assumed that a business will continue to operate for the foreseeable future. This assumption of a business having an indefinite life enables the distinction to be made between assets related to future reporting periods and expenses allocated to one reporting period.

Consistency

To enable effective comparison between performances in different periods, an organisation should apply methods of accounting consistently from one period to another.

Monetary unit

This principle is based on an assumption that to accurately interpret financial reports, a common unit of measurement that will not change in value over time must be used. Items must have a monetary value for accounting purposes.

Qualitative characteristics of information

All information must be relevant to the decision-making needs of its users. Information's relevance is affected by its materiality, which relates to the significance of the transactions, values and errors in the financial statements. For example, a business with revenue of \$20 million may not be concerned about missing stock worth \$1,000. However, a small business with revenue of \$50,000 would be concerned with such an amount.

All reports need to contain reliable information. Reliable information can be verified and audited; is objective, neutral and free from bias; and is paramount in establishing the truest financial standing of any business.

Australian Accounting Standards

To manage finances, organisations should follow the procedures, practices and disclosure requirements included in the Australian Accounting Standards maintained by the AASB, an Australian Government agency whose functions are set out in the *Australian Securities and Investments Commission Act 2001* (Cth). The Standards are applied to organisations within the public and private sectors. The Standards follow those issued by the International Accounting Standards Board (IASB) – the independent, accounting standard-setting body of the International Financial Reporting Standards Foundation (IFRS Foundation).

You can read more about the AASB Standards at: <http://aspirelr.link/aasb-standards>.

Financial probity and due diligence

Probity is the evidence of ethical behaviour in a process. Financial probity means that all organisational financial processes are carried out in accordance with relevant legislation, reporting requirements and appropriate standards to ensure the risk of fraud or corruption is minimised. Those responsible for organisational financial processes need to ensure that policies and procedures are developed based on the principles of objectivity, accountability, transparency, integrity and honesty.

Due diligence, which is referred to by many organisations as probity, actually relates to the formal process of validating information related to all areas of the organisation to support the management of financial risks. Due diligence may be provided by parties external to the organisation and is often conducted by purchasers prior to the final sale of businesses.

Accounting information systems

Some organisations use off-the-shelf financial management software (such as MYOB, Quicken or Xero), while other, usually larger organisations have software specifically developed to manage their finances. These systems support the process of recording and using a chart of accounts; reporting on business transactions for internal users; and meeting taxation and statutory reporting obligations, such as the business activity statement and financial reports.



The primary financial reports or statements used in financial management planning are the income (profit and loss) statement, the balance sheet and the cashflow statement. From the required data that has been entered into accounting software and/or Microsoft Excel, these reports are generated so that the reasons for previous profit or loss may be analysed and cashflow trends identified. Without this analysis, budgets cannot be developed to ensure the effective allocation and management of resources.

Review the suitability of accounting software

In reviewing the suitability of the software, you need to consider the following:

- Is the system ATO compliant, allowing the organisation to process and electronically lodge tax payments?

- Is the system Australian Securities and Investments Commission (ASIC) compliant, allowing the organisation to electronically submit forms and reports?
- Can the system effectively produce profit and loss statements, balance sheets and cashflow statements?
- Does the system enable managers to analyse data and produce variance reports?
- Does the system handle a number of users at the same time to efficiently process data and obtain information?
- Does the system allow you to keep financial records for each business or department within the organisation?
- Does the system allow for integration with existing systems relating to customer relationship management, human resource management, project management, production, purchasing, inventory management, sales and e-commerce?
- Is the system able to produce sales, purchases and inventory reports?
- Are expensive add-ons required to conduct analysis and present financial budgets and statements?
- If a change in system is made, what costs are involved in purchasing the software, implementing the software and training users?

Example: software packages and their suitability

Several off-the-shelf business management and accounting software packages are available, including the following:

- Xero (<http://aspirelr.link/xero>)
- MYOB (<http://aspirelr.link/myob>)
- Reckon (<http://aspirelr.link/reckon>)
- Cashflow Manager (<http://aspirelr.link/cashflow-manager>)
- Sage (<http://aspirelr.link/sage-software>)
- Nominal (<http://aspirelr.link/nominal-accounting-software>)



Identify the organisation's planning and financial cycle

Strategic plans, business plans, operational plans and financial reports are prepared according to the organisation's agreed cycle of reporting. This cycle is determined by identifying what decision-makers need for strategy development and implementation, and statutory requirements.

Financial reports

The number and types of financial reports prepared vary according to the activities of the business, the reporting requirements of relevant statutory bodies and the people who use the information to make decisions. Many financial reports are prepared to meet ATO submission dates and other statutory requirements. This calendar is reviewed regularly by the finance team to incorporate any changes made by regulators.

Organisational plans

Strategic, business or operational plans, which incorporate action plans and budgets, are generally developed annually and relate to the organisation's financial year. There may also be plans developed for specific projects, such as the development of a new product. The budgets are required for managers to ensure they have the financial resources for completing the activities. Regardless, each plan will have a budget that needs to be monitored on a regular basis, with the information from the analysis used to inform decision-making.

Practice task 1

1. What is the purpose of conservatism?

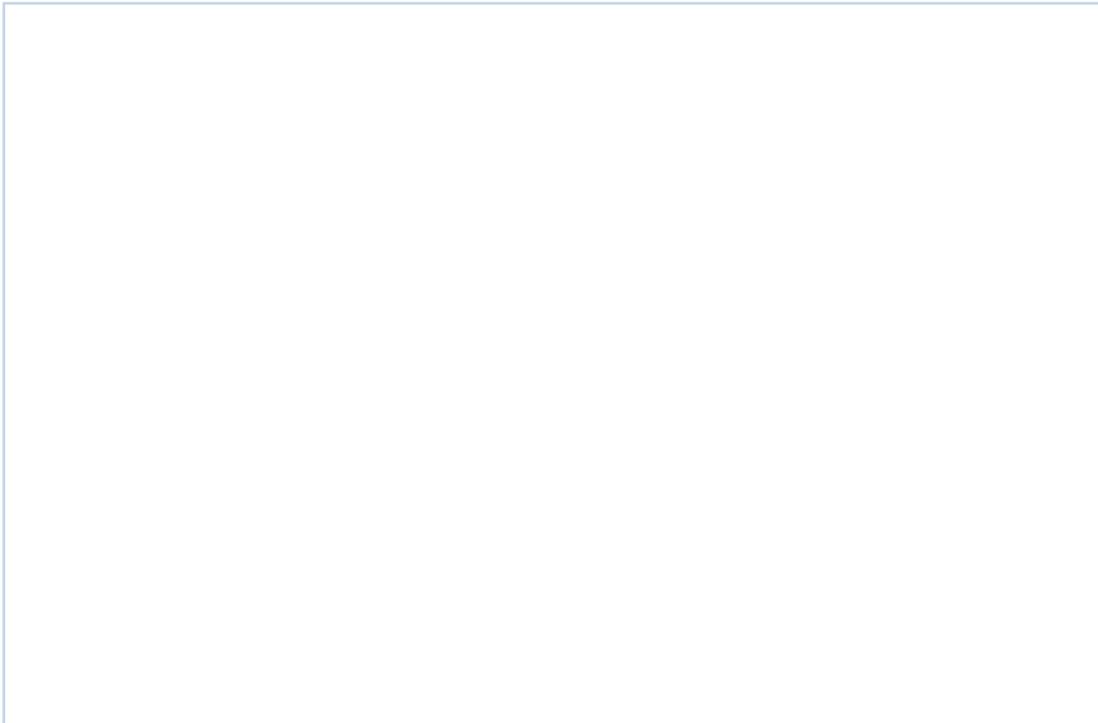
2. Take time to explore the AASB's website at: <http://aspirelr.link/aasb>.

What are the two key accounting standards that are directly relevant to gathering revenue data for statutory recording and reporting?

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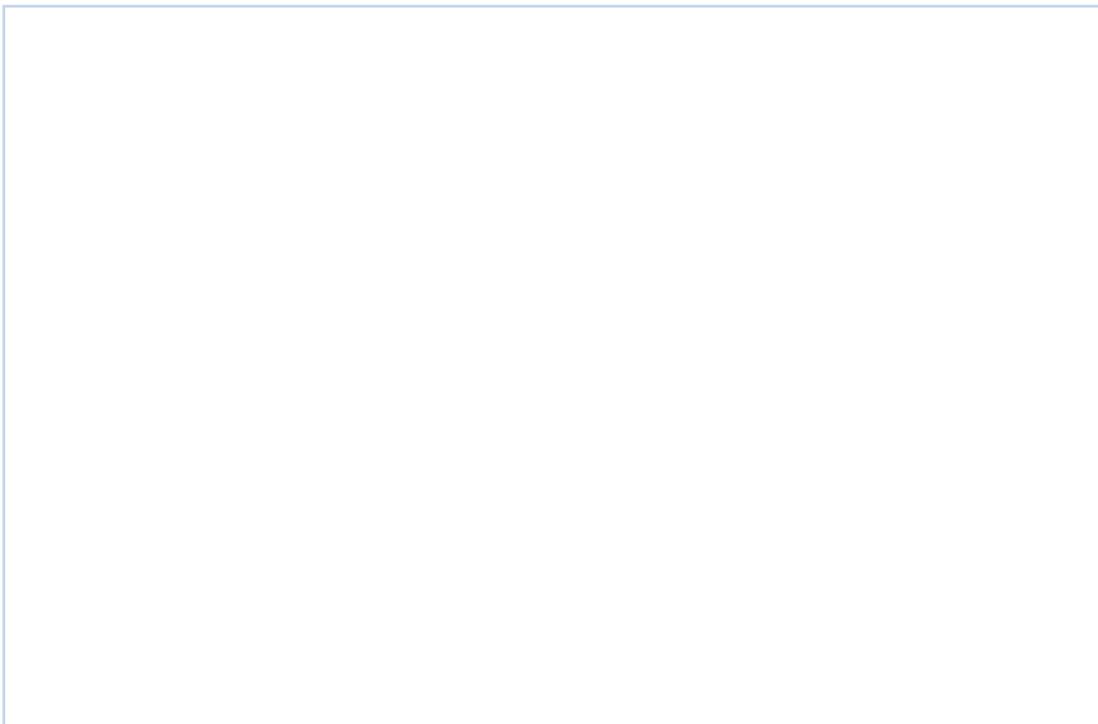
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3. According to the AASB, what does a set of financial statements comprise?



4. Review the features of off-the-shelf business management and accounting software products.

Imagine you are running a retail business, selling products via a bricks and mortar site and online. You need to manage inventory, point-of-sale and payroll, and would like a cloud-based system to work on financial planning and management at your warehouse, retail space and home on a variety of devices. Which product would you purchase? Why?



1B

Determine areas of profit and loss

To identify which areas of the organisation are generating a profit or loss and to determine the reasons for change, managers can analyse the profit and loss statement and the balance sheet. The profit and loss (P&L) statement, sometimes referred to as the income statement, measures and reports how much profit has been generated in a specific period of time (for example, a month, quarter or year). The balance sheet represents the organisation's financial position based on what it owns and owes. The organisation's financial position is the economic condition of the business, its financial structure and its level of solvency.

Understand the profit and loss statement

The P&L statement essentially reports on the earning activities of the business whereby:

$$\text{Net Profit (Loss)} = \text{Revenue} - \text{Expenses}$$

Therefore, net profit is the balance between the revenues (for example, sales, commissions, interest earned) and the expenses (for example, wages, inventory, electricity, advertising) of the organisation over the period. When revenues are greater than expenses, a net profit is made by the business and is recorded as a positive. When expenses exceed revenue, a net loss is recorded as a negative. Positives and negatives are normally ascertained through the use of black and red text.

Example: a profit and loss statement

The following is an example of a P&L statement. The statement lists and summarises the income and expenses. The difference between these two items is a net profit. In the case of a not-for-profit organisation, 'surplus' may replace profit and 'deficit' may replace loss.

A2Z Business Pty Ltd	
Profit and loss statement for the year ended 30 June 2015	
	\$
Revenue	
Sales	55,250
Interest earned on investments	7,000
TOTAL REVENUE	62,250
Expenses	
Wages and salaries	38,000
Rent	8,500
Electricity	2,500
Telephone/Internet	950
Interest paid on loan	2,100
TOTAL EXPENSES	52,050
NET PROFIT	10,200

Analyse the profit and loss statement

An analysis of the P&L statement enables managers to calculate profit margins. Once profit margins have been determined, managers can compare them with previous periods – Year to Date (YTD) – to identify the impact of issues such as increasing costs or low selling prices. Individual product lines can also be compared to identify their current profitability.

Here are some examples of financial ratios that are used to analyse profit.

Gross profit margin

Gross profit margin relates the gross profit of the business to the sales generated during the same period. Gross profit represents the difference between sales and cost of sales. The formula used to calculate this is as follows:

$$\text{Gross profit margin \%} = (\text{Gross profit} / \text{Sales}) \times 100$$

Net profit margin

Net profit margin relates the net profit for the period to the sales during that period. Here is the formula:

$$\text{Net profit margin \%} = (\text{Net profit before interest and taxation} / \text{Sales}) \times 100$$

Net profit ratio

After taking account of all the costs, the net profit is the amount that remains. The net profit ratio shows the number of cents in each sales dollar that remains. This is the calculated profit after all the costs of operating the business have been paid.

The net profit ratio is calculated with the following formula:

$$\text{Net profit ratio} = (\text{Net profit after tax} / \text{Net sales}) \times 100$$

Example: profit margins

The following example is of the gross profit margin and net profit margin for two products sold by Lansing Traders during the past month.

Product	COGS/ unit	Fixed costs/ unit	Selling price/ unit	Gross profit/ unit	Units sold	Revenue	Gross profit margin	Net profit margin
Zodiac chain wallet	\$30.00	\$20.00	\$120.00	\$90.00	50	\$6,000	75%	58%
Leather travel wallet	\$35.00	\$20.00	\$129.00	\$94.00	60	\$7,740	73%	57%

Example: net profit ratio

The following shows the net profit ratio for a company called Design Z Emporium.

Net sales (net profit - sales returns)	\$100,000
Total expenses	\$40,000
Income before tax	\$60,000
Tax rate	35%

For Design Z Emporium to work out its net profit, the net profit ratio will need to be calculated as follows:

Profit after tax = \$60,000 x (1 - 0.35) = \$39,000

Net profit ratio = (\$39,000/\$100,000) x 100 = 39% or \$0.39

Thus 39 per cent (or 39 cents) of each sales dollar is left as net profit after all the costs of Design Z Emporium have been covered.

Calculate cashflow ratios

There are a number of ratios to help analyse the organisation's cashflow, as shown below.

Cashflow solvency

This ratio measures the organisation's ability to pay debts, and therefore indicates financial strength or problems, and the ability to implement strategies. A low ratio indicates the organisation may not be able to meet debts. The formula is:

Cashflow solvency = Cashflow from operating activities / Total liabilities

Cashflow margin

The cashflow margin measures how an organisation converts sales to cash. The higher the margin, the more cash is available to engage in business activities to meet organisational objectives. The calculation is:

Cashflow margin = Cashflow from operating activities / Sales

Cashflow return on assets

The cashflow return on assets (ROA) ratio enables managers to see how efficient the organisation is compared to other, similar organisations. The return can also be compared with past ratios to identify trends. The formula is:

Cashflow return on assets = Cashflow from operating activities / Total assets

Understand the balance sheet

The balance sheet is a financial snapshot of the business as it currently stands, that is, the financial stability of the organisation today. Though the balance sheet does not actually show financial profit, managers can review profitability by looking at the owner's equity.

Here is a basic description of some key balance sheet terms.

Fundamental accounting equation

Assets = Liabilities + Owner's Equity

Assets and residual balance

This fundamental equation recognises that a portion of an organisation's assets are financed by debt (liabilities) and the residual balance (owner's equity) represents the right of owners to the organisation's assets only after all creditors have been paid.

Balance sheet assets and liabilities

Assets and liabilities can be either current or non-current. Within the asset and liability sections of the balance sheet, items are listed in terms of their liquidity.

Example: a balance sheet

The A2Z balance sheet below provides information on the company's financial standing as at 30 June 2015. This balance sheet shows what A2Z has (assets) and what it owes against those assets (liabilities). The difference between the assets and the liabilities shows the net worth of the business.

A2Z Business Pty Ltd			
Profit and loss statement for the year ended 30 June 2015			
ASSETS	\$	LIABILITIES	\$
Current			
Cash (bank account)	12,500	Creditors (accounts payable)	17,000
Debtors (accounts receivable)	10,500	Wages payable	1,250
Stock	3,500		18,250
	26,500		
Non-current			
Motor vehicles	20,000	Loan	8,000
Machinery	2,000	Mortgage	105,000
Production equipment	10,000		113,000
Land	55,000		
Buildings	35,000	TOTAL LIABILITIES	131,250
	122,000		
		OWNER'S EQUITY	
		Capital	17,250
TOTAL ASSETS	148,500		148,500

Calculate owner's equity

In addition to relating profits or losses to sales, it is also useful to express them in terms of total owner's equity, as this provides a measurement of the return being generated on the funds being invested in the business by the owners or shareholders. The return on owner's equity indicates how efficiently the business has used the resources provided by the owner. The ratio enables the owner to evaluate the return being generated by the business against that available from alternative forms of investment with similar levels of risk and, if necessary, to decide whether to withdraw funds from the business and invest them elsewhere.

Here are two descriptions of ratios used to assess owner's equity.

Calculating the owner's return from business

Return on owner's equity ratio = (Net profit / Average owner's equity) x 100

Calculating average owner's equity

Average owner's equity is calculated by taking the level of owner's equity at the beginning and end of the period and dividing by two to get the average for the entire period.

Average owner's equity = (OE at beginning of period + OE at end of period) / 2

Example: the return on owner's equity ratio

Pantonellic Enterprises shows a net profit of \$23,000 for the year ended 30 June 2014 and \$25,000 for the year ended 30 June 2015. The owner's equity section of the balance sheet shows the following balances.

Year ended 30 June	Balance
2013	190,000
2014	200,000
2015	237,000
The calculation of the return on owner's equity for 2013–14: (23,000 / 195,000) x 100 = 11.79%	The calculation of the return on owner's equity for 2014–15: (25,000 / 218,500) x 100 = 11.44%

In this example, the return on owner's equity ratio has decreased, indicating that the owner's return from Pantonellic Enterprises has diminished. In 2013–14, each dollar of owner's funds invested yielded 11.79 per cent in net profit; this dropped to 11.44 per cent in 2014–15. Although profits increased from \$23,000 to \$25,000 (an 8.7 per cent rise), the average owner's equity increased by 12.1 per cent. The ratio dropped because the funds invested grew at a higher rate than profitability.

For Pantonellic Enterprises, the trend shows the business has not been as effective in using owner's funds to generate profits in 2014–15 as in 2013–14. Although the trend is unfavourable, the owner may still consider the 11.44 per cent return adequate compared with alternative investment returns. This trend for Pantonellic Enterprises must nevertheless be investigated.

Return on assets ratio

The ROA ratio is similar to the return on owner's equity ratio because it looks at how effectively the organisation has used the resources at its disposal to generate profits. The following information shows how the ROA ratio is calculated.

Return on assets

ROA % = (Net profit before interest and taxation / Average of total assets) x 100

Taxation and interest expenses

When calculating the ROA, the organisation's taxation and interest expenses are added back to profits to reflect the fact that interest and tax payments are separate from the manner in which assets are used.

Average of total assets

The organisation's total assets include both current and non-current assets. The average of total assets is used rather than the asset levels at the end of the period, as this reflects the assets the organisation had at its disposal throughout the financial reporting period.

Example: return on total assets ratio

For Pantanellic Enterprises, net profits for 2013-14 and 2014-15 were \$23,000 and \$25,000 respectively.

The assets section of the balance sheet showed the following balances:

Year ended 30 June	Current assets	Non-current assets	Balance
2013	150,000	210,000	360,000
2014	145,000	225,000	370,000
2015	165,000	300,000	465,000

The tax and interest expenses for the business were:

Year ended 30 June	Tax expense	Interest expense
2014	9,200	2,500
2015	9,700	3,300

The calculation of the return on total assets is as follows:

2013-14	2014-15
$(34,700 / 365,000) \times 100$ = 9.51%	$(38,000 / 417,500) \times 100$ = 9.10%

continued ...

... continued

This example shows that Pantanellic used its asset base less effectively in 2014–15 (9.10 per cent return) than in 2013–14 (9.51 per cent return). Although net profits before interest and tax increased from \$34,700 to \$38,000, the business had substantially more assets on average with which to generate profits (\$417,500 in 2014–15 compared with only \$365,000 in 2013–14). Pantanellic was unable to use its larger asset base to generate profits at the same rate as the previous year.

Monetary profits grew from \$34,700 to \$38,000, but the organisation actually used its assets less effectively than the previous year, as reflected in its ROA – a substantial increase in assets on hand resulted in profits only rising by \$3,300.

Conduct cost-volume-profit analysis

Cost-volume-profit (CVP) analysis is a technique used to identify the organisation's most profitable products or services, and the effects of procured profits when there are changes in product costs and volumes. This can be performed for one period or used to track margins over time by comparing one period to another. Managers can perform CVP analysis to plan future levels of activity and volume projections. Contribution margins, break-even analysis and operating leverage are commonly used tools for conducting CVP analysis, as shown in the following information.

Contribution margin analysis

The contribution margin is the calculation of total revenue minus total variable costs, and is useful when looking at the effects of volume on profit. To calculate the margin, all costs must be divided into fixed and variable categories. The focus is on variable costs as these are the costs that are likely to change within a period of time, such as the price of raw materials. This analysis helps to determine whether a product should be added or subtracted from a line and how to price the products.

Break-even analysis

To determine whether the organisation's activity level covers the costs associated with running it, a break-even analysis can be performed. The analysis can also be used to monitor the product level. The break-even point occurs when total revenue equals total fixed and variable costs.

Operating leverage

Operating leverage enables managers to determine the effect of fixed costs on profit and loss. Operating leverage is calculated by dividing the contribution margin by the net income. An organisation with a higher proportion of fixed than variable costs has high operating leverage due to the stability of costs. High variable costs may mean an organisation can respond more easily to sales decreases.

Conduct horizontal analysis

Horizontal analysis is an alternative to ratio analysis. It involves the analysis of how each item in the financial statements has changed from this period to last. Most large organisations provide a horizontal analysis in the financial statements of their annual report. These statements are referred to as comparative financial statements and show the results for the two most recent years.



Horizontal analysis looks at the change in each item of the financial statements in three ways:

- the change in absolute monetary value
- the percentage change from the value of the previous period
- whether the change was favourable or unfavourable for the organisation.

Example: horizontal analysis

The following analysis for Carapel Industries shows that overall net profit rose by 42.9 per cent for the year, which is a good result for the business. However, when undertaking the horizontal analysis, it is essential that you probe further. In fact, Carapel Industries's profits rose mostly as a result of sales increasing by 18.6 per cent, while expenses decreased by only 4.3 per cent.

Carapel Industries					
Comparative income statement for the month of March 2014 and 2015					
Horizontal analysis					
	March 2015	March 2014	Dollar amount	Per cent	
Sales	1,245,000	1,050,000	195,000	18.6	F
Less cost of goods sold	1,070,000	900,000	170,000	18.9	F
Gross profit	175,000	150,000	25,000	16.7	F
Add commission	350	350		0.0	-
	175,350	150,350	25,000	16.6	F
Less operating expenses					
Sales salaries	22,500	25,000	-2,500	-10.0	F
Delivery vehicle expenses	435	400	35	8.8	U
Advertising	890	1,100	-210	-19.1	F
Rent	10,200	9,900	300	3.0	U
Administration salaries	30,750	34,000	-3,250	-9.6	F
Telephone	3,300	3,000	300	10.0	U
Rates and taxes	1,750	1,150	600	52.2	U
Power and fuel	7,550	7,250	300	4.1	U
Office expenses	1,735	890	845	94.9	U
Interest	845	900	-55	-6.1	F
	79,955	83,590	-3,635	-4.3	F
Net profit	95,395	66,760	28,635	42.9	F

F = Favourable U = Unfavourable

continued ...

... continued

Several issues require further examination:

- What factors led to sales increasing by nearly 20 per cent? This is a significant increase.
- The report showed that sales department salaries, advertising and administration salaries all decreased significantly. What strategies were used to achieve this and how can they be maintained?
- Rates and taxes (52 per cent) and office expenses (95 per cent) grew dramatically over the previous year. Why? How can these expenses be reduced for the coming periods?

Determine reasons for variations

Though the net profit ratio indicates the efficiency of business operations after accounting for other operating expenses, the percentage should be compared with expectations, previous years' financials and other company or industry standards. Variations may be due to a number of reasons, as shown here.

Reasons for variations

- Decreased or increased selling prices
- Lower demand for products as a result of increased players in the market
- Decreased or increased cost of goods purchased
- Increased or decreased production costs
- Increased or decreased labour costs
- Changes in the organisation's inventory method
- Capital injections by business and/or owners
- Withdrawals by owners
- Investments in assets
- Changes in business taxation obligations

Reports on financial issues

- Costs of goods sold budget reports
- Production costs budget reports
- Capital expenditure budget reports
- Operating expenses reports
- Inventory budget reports
- Marketing and sales budget reports to determine the impact of current selling price; for example, selling prices may be too high and not capturing the market
- Market share and market standing reports comparing performance to competitors, and of new products and services in new markets
- Asset reports
- Annual reports
- Audit reports

Practice task 2

1. Calculate the revenue, gross profit and net profit margins for these products.

Product	COGS/ unit	Fixed costs/ unit	Selling price/ unit	Gross profit/ unit	Units sold	Revenue	Gross profit margin	Net profit margin
Front pocket wallet	\$27.00	\$16.00	\$89.00	\$62.00	40			
Compact smart phone wallet	\$29.00	\$17.00	\$99.00	\$70.00	37			

2. What is the formula for calculating the contribution margin?

3. When calculating the contribution margin, why are only variable costs considered?

4. In what three ways does horizontal analysis look at the change in each item of the financial statements?

1C

Determine required resources for organisational strategy implementation

To determine the financial resources required for organisational activities, managers can review the organisational plans, paying particular attention to the budgets. The plans and their budgets will not only identify the financial resources required within the next financial cycle, but also dictate when exactly they will be required. To ensure that financial resources are available, managers need to analyse the organisation's cashflow on a regular basis.

Review plans to determine requirements

Managers need to familiarise themselves with the strategic or business and operational plans for the next financial cycle. This is to gain an understanding of what resources are needed to undertake activities to meet organisational objectives.

The types of plans that need be reviewed will depend on the size and nature of the organisation. A description of the types of plans, and the budgets prepared to support them, is provided here.

Types of plans

- Strategic and business plans outline key strategies and the initiatives to implement those strategies – such as adding products to a product line or acquiring another company to achieve growth.
- Competitive or tactical plans in large organisations relate to an organisational division and outline actions to implement strategies for operating in different industries or markets.
- Operational plans relate to units, departments or teams and outline the low-level day-to-day activities and processes to ensure the strategies implemented achieve organisational objectives.
- Specific plans focus on particular projects; for example, a project plan designed to implement a new management information system.

Budgets

- Strategic and business plans will need budgets for the entire organisation, specifying the money required to implement strategy initiatives.
- The strategic or master budget should assist managers in analysing cashflow trends to determine an organisation's ability to implement a budgetary strategy.
- Operational plans generally include budgets, such as the cost of goods sold (COGS) budget, operating costs or fixed costs budgets, capital budgets, inventory budgets, and marketing activities budgets. Generally, these plans are developed following the strategic plan.

Understand the organisation's cashflow

Cashflow refers to the incomings and outgoings of cash for an organisation. Cash is different from profit: an organisation may be profitable, but have a negative cashflow, and therefore not be able to pay its debts. Many organisations have numerous assets, but minimal accessible cash.

When taking into account the cost of implementing an initiative to meet organisational objectives, if a negative cashflow position is likely, additional cash may need to be borrowed or an overdraft facility put into place. A cashflow projection is required to obtain finance and future cashflows are determined by the expected timing of income and expenditure.



Review cashflow statements

Cashflow statements comprise three elements, which are described below. The most important of these elements is the operating activities element.

Operating activities

Operating activities represent the cash inflow from operations and cash paid. The net income from sales is part of this section, as are purchases of raw materials, marketing costs and product shipping.

Investing activities

These activities are concerned with cash payments to acquire assets and the cash received for the disposal of assets (such as machinery and equipment).

Financing activities

These activities relate to the financing of the business; for example, a loan to the business and payments to the lender to repay the loan. Money from the issue or re-purchase of shares or bonds is included in this section.

Example: cashflow statement

An example of a cashflow statement can be found at: <http://aspirelr.link/rba-cashflow-statement-2018>

Identify cashflow trends

Trends may be identified by plotting key ratios on a graph, giving a visual representation of changes happening over time from different financial periods – whether they be months, quarters or years.

The cashflow ratio provides the information that helps managers to forecast their organisation's cashflow. Positive trends, for example, may lead to investment for growth as there is confidence in the organisation's ability to obtain and pay back loans.



Practice task 3

1. Many government and accounting professional organisations have websites that provide information to help people without professional accountancy qualifications to manage their personal and business finances. Visit the following sites to explore the resources available to help you manage your organisation's finances:
 - CPA Australia, 'Financial management of not-for-profit organisations', [<http://aspirelr.link/financial-management-not-for-profits>]
 - International Federation of Accountants, 'Public sector financial management transparency and accountability', [<http://aspirelr.link/public-sector-financial-management>]
 - Queensland Government, Business and industry portal, 'Managing cash flow', [<http://aspirelr.link/managing-cash-flow>]
 - Queensland Government, Business and industry portal, 'Trend analysis for business improvement', [<http://aspirelr.link/trend-analysis>]
2. Explain the value of trend analysis to identify cashflow trends.

1D

Review statutory requirements and taxation liabilities

Australian organisations have statutory requirements affecting the manner and frequency of their financial reporting. They also have liabilities in the form of taxation. To ensure statutory requirements are met, the organisation needs to understand what these requirements and liabilities are, the regulatory bodies to whom the financial reports and payments must be submitted, the formats to be used when supplying the information, and the time lines and constraints for the submission of reports and payment.

Some of the regulatory requirements include:

- the reporting of goods and services tax (GST) and other taxation-related issues relating to the business activity statement
- administering and reporting the superannuation guarantee levy
- complying with the capital gains tax and fringe benefits tax regulations
- compliance with the *Income Tax Assessment Act 1997* (Cth)
- compliance with the corporations law, including the *Corporations Act 2001* (Cth)
- compliance with the Australian Accounting Standards
- compliance with relevant state/territory taxation requirements, such as payroll tax and superannuation payments.

Key regulating bodies

The main bodies regulating how organisations report their financial affairs are described here.

Australian Taxation Office (ATO)

Reporting of income and expenditure for GST purposes is required throughout the year, as are estimates of business and investment income, with a final detailed statement of income and eligible deductions at the end of each financial year. Companies are also required to pay their income tax to the ATO quarterly using a business activity statement and prepare an income tax return at the end of each year in accordance with the requirements of the *Income Tax Assessment Act 1997* (Cth).

Read more about the requirements for businesses on the ATO's website:
<http://aspirelr.link/ato-business>.

Australian Securities and Investments Commission (ASIC)

ASIC is the chief regulatory agency of all incorporated entities (public and private) and fund managers within Australia. ASIC is responsible for protecting investors and consumers in the Australian financial system. It is also responsible for the administration and enforcement of the:

- *Corporations Act 2001* (Cth)
- *Australian Securities and Investments Commission Act 2001* (Cth)
- *Insurance Contracts Act 1984* (Cth)
- *Superannuation (Resolution of Complaints) Act 1993* (Cth)
- *Superannuation Industry (Supervision) Act 1993* (Cth)
- *Retirement Savings Accounts Act 1997* (Cth)
- *Life Insurance Act 1995* (Cth)
- *Medical Indemnity (Prudential Supervision and Product Standards) Act 2003* (Cth).

Read about the reporting requirements for different types of organisations at:
<http://aspirelr.link/lodging-financial-reports>.

Australian Securities Exchange (ASX)

Australian companies listed on the stock exchange must report to the ASX any significant business issue that may reasonably affect company share values or investors' decision-making. Copies of an organisation's audited annual reports and half-yearly reports that are submitted to ASIC must also be lodged with the ASX. The ASX's additional requirement is that a preliminary final report must be lodged in the same format as ASIC's half-yearly report within 75 days of the end of the accounting period. Final annual accounts must be supplied within 90 days of the end of each financial year.

Companies that have announced significant capital expenditure commitments must also lodge quarterly cashflow statements during the periods in which the expenditure is being undertaken. Mining companies, for example, must lodge quarterly cashflow reports and summaries of mining exploration activities during the financial period. Read about the ASX's rules, guidance notes and waivers on its website at: <http://aspirelr.link/asx-rules-guidance-notes>.

Australian Prudential Regulation Authority (APRA)

APRA is the Federal Government agency responsible for regulating the financial health of Australia's banks, life and general insurers, building societies, credit unions and superannuation funds. APRA's purpose is to ensure that the financial services industry is operating prudently and in the best interests of investors and those who are insured. If another non-financial services company owns these businesses, the parent company must also comply with the normal ASIC reporting time frame.

The requirements for reporting to APRA depend on the type of institution. That is, there are different frameworks for authorised deposit-taking institutions (ADIs), general insurers, superannuation organisations, life insurance and friendly societies, and for non-regulated entities. To learn about the reporting frameworks for different institutions, visit APRA's website at: <http://aspirelr.link/apra>.

Review taxation liabilities

The calculation and submission of taxation liability is an important part of an organisation meeting its statutory reporting requirements. Managers need to be aware of specific forms of taxation, such as GST liability and payroll tax, which must be calculated and provided for on a regular basis.

Here is a description of some of the major forms of taxation.

Goods and services tax

Most organisations with an annual turnover of \$75,000 or more are required to register for the goods and services tax (GST). Not-for-profit organisations must register for GST if their annual turnover exceeds \$150,000. Annual turnover is the total revenue from sales and services provided for the year, excluding GST.

Organisations registered for GST must comply with legislative requirements. It may be your responsibility to obtain the information from the organisation's accounts.

Payroll tax

Payroll tax is a state/territory tax imposed on organisations with a total Australian payroll that exceeds the payroll tax-free threshold. The threshold applicable varies between the states and territories. Calculation of the total Australian payroll includes payments made to or on behalf of employees.

Organisations registered for payroll tax are required to complete a monthly payroll tax return and submit it to the state revenue office with the payment by a specified date; for example, in Victoria it is the seventh day following the end of the month.

Fringe benefits tax

Organisations that provide employees with payments in the form of non-cash benefits may have to register for and remit fringe benefits tax (FBT) at the rate equal to the top marginal rate of personal taxation plus the Medicare levy, because the benefit is deemed to be a substitute for taxable income.

The FBT year runs from 1 April to 31 March, and the rate is subject to change as the Australian financial climate dictates. Employers must calculate the amount of fringe benefits provided to employees during the FBT year, calculate the amount of FBT payable, and complete an FBT return form. Amounts are recorded as liabilities in the general ledger. The timing of the FBT payment is determined by the total amount that is payable and whether the employer has previously lodged an FBT return.

Pay as you go

Pay as you go (PAYG) is a system of taxation on income. PAYG legislation is found in Schedule 1 of the Taxation Administration Act 1953 (Cth) and is broken down into two areas: PAYG withholding and PAYG instalments. The required data to calculate PAYG can be obtained from the payroll accounts of the organisation.

Organisations pay tax instalments on their business and investment income, allowing them to pay their tax obligations 'as they go' rather than being required to pay a lump sum amount of tax at the end of the financial year.

Superannuation

All employers are required to contribute to a complying superannuation fund for all eligible employees (currently a minimum of 9.5 per cent of gross ordinary income).

When a company fails to make these contributions, the government effectively fines the business an equivalent amount and holds it on behalf of the employees until the organisation makes arrangements with a complying fund. The government also charges interest on the amount involved and an administrative fee per employee.

Organisations must therefore ensure all employees belong to a complying superannuation fund so payments can be remitted to their accounts accordingly.

Practice task 4

Explore the ATO's website, visiting the sections for business, non-profit organisations and superannuation.

1. What are the due dates for lodging and paying an organisation's business activity statement (BAS) online?

continued ...

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2. What are the due dates for an organisation's lodgement of their income tax return?

Summary

1. The purpose of financial management is to ensure funds are available for an organisation to pay for materials, staff, outsourced services and other operating costs within the required legislative time frames.
2. To effectively manage finances, all managers require knowledge of the accounting process, accounting principles, the qualitative characteristics of financial statements and reports, and accounting standards and systems.
3. Analyses of the P&L statement and the balance sheet enable managers to identify which areas of an organisation are generating a profit or a loss and to determine the reasons way this is so.
4. The financial position of the organisation is the economic condition and financial stability of the business, its financial structure and its level of solvency.
5. To determine the financial resources required for organisational activities, managers can review the organisational plans, paying particular attention to the budgets. To ensure financial resources are available, managers need to analyse the organisation's cashflow.
6. Ratio, horizontal and trend analyses are critical in planning for the management of finances. Findings from different periods, whether years, quarters or months, can be compared with trends in different components that will help plan the budgets for the next period.
7. Australian organisations have statutory requirements affecting the manner and frequency of their financial reporting, and have Commonwealth and state/territory taxation liabilities.

Learning checkpoint 1

Plan for financial management

This learning checkpoint allows you to review your skills and knowledge in planning for financial management.

Part A

1. Explain the relationship between Australian Accounting Standards and accounting principles.

2. Define 'financial probity'.

3. Why does the balance sheet not provide an accurate picture of the organisation's profitability?

4. What is the value of performing breakeven analysis?

5. Why may an organisation be required to register for and remit fringe benefits tax (FBT)? Where are FBT payments recorded in the organisation's chart of accounts?

6. What ratio would you use to analyse trends in an organisation's cashflow over a number of periods? Why?

Part B

In this section you are required to consider the implementation of budgets for your organisation, or one that you are familiar with. This may be an organisation that you have previously worked for or one that you are in close contact with, such as your training provider, a not-for-profit organisation you volunteer for, or a sporting or social club.

1. Document the organisational planning and financial cycle.

2. Assess your organisation's business and accounting software's ability to meet organisational and statutory requirements. Outline your findings.

3. Review your organisation's most recent profit and loss statement. If you are reviewing the statements of an organisation that you do not currently work for, locate its annual report and make your calculations based on the information from the annual statements. Calculate the organisation's:
- gross profit margin
 - net profit margin
 - net profit ratio
 - return on owner's equity
 - return on assets.

4. Research the organisation's tax obligations, then answer the following:
- a) What are the due dates for lodging and paying GST?
 - b) What are the due dates for lodging and paying income tax?
 - c) What are the due dates for lodging and paying relevant state/territory tax?

Topic 2

Establish budgets and allocate funds

A budget is a financial plan of an organisation's expected financial performance in a particular area of activity or aspect of its operations for a specified period of time. A budget enables managers to allocate funds to complete organisational activities and to control finances through regular analysis of budgeted to actual performance. Budgets therefore help to make decisions to minimise risk to financial viability.

In this topic you will learn how to:

- 2A Set budgets and allocate financial resources
- 2B Prepare the cash budget
- 2C Prepare the profit and loss and balance sheet budgets
- 2D Develop risk and contingency plans

2A Set budgets and allocate financial resources

An organisational budgeting process involves the preparation of budgets for all areas of activity within the business and is the essential first stage in achieving effective planning and financial control. The content of all individual or activity budgets related to units or departments (in smaller organisations these may be forecasts only) – such as the marketing budget for implementing and evaluating marketing strategies – are summarised in a master budget. At the least, this should contain an organisation's cash budget, profit and loss budget, and balance sheet budget.

Identify an organisation's budget setting approaches

An organisation's prescribed policies and procedures and its perspective on its financial standing will often be reflected in its approaches to budgetary requirements. The methods used and types of budgets developed will vary from one organisation to another. Here is a brief description of the different budget-setting approaches that may be adopted.

Budgeting responsibilities

For large organisations, there may be a budget committee, consisting of a business unit or departmental managers. The person in charge of the process in most organisations is the owner, finance manager or director.

Top-down/bottom-up

If an organisation takes a top-down approach, each business or unit manager is generally responsible for setting the budget for their area. With a bottom-up approach, the budget input is coordinated by lower levels such as team leaders.

Budgeting methods

Budgeting methods include incremental and zero-based budgeting. Incremental budgeting is based on what happened in the previous year with adjustments for expected future issues or events such as increased interest rates, changes in the value of the Australian dollar and inflation. Zero-based budgeting involves managers considering the resources required for activities to enable their area to meet organisational objectives.

Budget parameters

Most organisations' budgets are set for a 12-month cyclical period, but this will depend on the industry. An organisation operating within a fast-moving industry such as information technology may set rolling monthly budgets.

Allocation of resources and budgeting

With incremental budgeting, the allocation of resources is based on allocations from the previous period. The issue with this approach is that it fails to take into account new financial strategies. If areas require more funding than usual to implement the strategy, they may not receive the right amount of funding to perform these activities. However, if an organisation's strategy is designed to maintain stability, then the process of allocating resources is relatively simple, based on previous performance.

For organisations that have developed new strategies and/or those that operate in dynamic industries, zero-based budgeting allows for an effective allocation of resources to meet the objectives identified in the strategic or business plan. Zero-based budgeting means each area must justify their activities in relation to organisational objectives, usually by conducting cost-benefit analyses.



Example: an organisation's budgeting process

Here is an outline of the master budgeting process for Coehlo Fixtures, a medium-sized manufacturing company.

- An organisational budget committee, consisting of the unit (area) managers, is led by the general manager. This committee reviews the financial statements for the current period and identifies the organisation's cash position.
- The strategic plan is reviewed, the required strategy for implementation is identified and organisational objectives are confirmed.
- Each area manager is to develop their business plan, which consists of planned activities and their budgeted costs to meet organisational objectives. This process will involve forecasting demand, sales and the purchase of resources for production. This development process requires close collaboration whereby the:
 - marketing and sales department leads the development of the sales forecast and budget (which will be completed before the other budgets)
 - production department leads the development of the production budget and of the capital expenditure budget
 - procurement area leads the development of the materials and inventory budgets
 - human resources department leads the development of the labour budget
 - finance and accounts departments lead development of the administrative expenses budget.
- The general manager will work with the departmental and area managers to review the budgets to develop the profit and loss budget and financial budgets, which consist of the cash budget and the budgeted balance sheet.
- The budget committee will ensure the organisation's master budget meets all statutory and legislative requirements.



Practice task 5

1. What three budgets and budgeted statements should an organisation's master budget include to ensure effective decision-making and probity and to meet statutory and legislative requirements?

2. Explain the difference between incremental and zero-based budgeting methods.

3. Is zero-based budgeting a more appropriate method of allocating resources for organisations with new strategies requiring new organisational activities? Explain your answer.

2B Prepare the cash budget

The cash budget, which predicts cash inflows and allocates cash outflows, is often considered an organisation's most important budget because it enables the analysis of its financial health on a regular basis. The budget also aims to ensure an organisation will have the working capital required to meet activity costs. This process relies on effective cashflow forecasts.

Forecast cashflow

Forecasting cashflow involves estimating the expected cash inflows (cash receipts) and adding the expected cash outflows (cash payments) for a period. The Net cash position = Cash receipts – Cash payments. This is generally calculated for each cyclical month.

Estimate cash inflows

The cash an organisation receives may include customer payments, earnings from the sale of assets, interest earnings, dividends, and sponsorship and government grants. This requires having forecasted sales, which are usually managed by the marketing team. Managers need to determine what will be customer cash and what will be credit payments, and when they are likely to be paid. The expected payments need to be placed in the month's actual cash that will be received. Consider the organisation's credit management or debt collection policy to determine when credits for sales will be paid.

Estimate cash outflows

Cash outflows can be identified from the items listed in the expenses/costs forecast. These may include salaries, loans, taxes and supplier payments for inventory, raw materials and services. Payments for inventory may be determined as a percentage of forecasted sales.

Managers should also determine when payments need to be made, and enter them in the month they will be made.

Add contingency

It is essential that managers ensure there are contingencies in place to deal with unexpected issues. Managers need to consider 'what if' scenarios to be able to determine the impact of possible sales declines. These scenarios may include inventory and raw material cost increases, supply and demand fluctuations and possible equipment breakdowns. Potential changes in interest rates should also be taken into consideration, as these would affect (at the very least) loan payments. This is discussed in greater detail later in this topic.

Example: cashflow forecasts

A number of cashflow forecast templates have been developed by the federal and state governments to help people who need to prepare a forecast for their organisation, but do not have existing tools to use. Here are some helpful websites where you can access templates and additional information:

- Government of Western Australia, Small Business Development Corporation, <http://aspirelr.link/business-tools-and-templates>
- State Government Victoria, Business Victoria, 'Cash flow forecasting', <http://aspirelr.link/cash-flow-forecasting>
- Tasmanian Government, business.tas.gov.au, 'Preparing a cash flow forecast', <http://aspirelr.link/preparing-a-cash-flow-forecast>

Analyse the sales forecast and budget

Sales forecasts are estimates of an organisation's sales for a specific period. The forecast, which is typically prepared by the marketing team, identifies the unit and dollar sales for a future period, based on sales trends and market research. From the forecast, a sales budget is prepared to determine the expected volume of sales. This budget is used for making decisions related to purchasing, production and, of course, cashflow.

Two common methods are used for sales forecasting, as shown here.

Qualitative methods

Qualitative methods are used when there is limited previous financial data available, such as for new products. Market research will identify the market demand and conditions that affect future sales of these products, such as interest rates and shifts in disposable income.

Some organisations use the Delphi technique, whereby a panel of organisational specialists from the marketing, sales, operational and finance areas independently provide financial forecasts. The experts then get together to reach a consensus on a combined forecast.

Quantitative methods

Quantitative analysis methods are more complex, in that they use mathematical equations to determine and express relationships between variables and require skills in using software such as System Applications and Products (SAP) and Excel.

Two examples of quantitative methods are:

- Time series, which use historical data to forecast sales based on past sales trends, seasonal periods (e.g. Christmas) and patterns over time. To learn more about time series data, visit the Australian Bureau of Statistics website at: <http://aspirelr.link/using-time-series-data>.
- Causal forecasting, which uses regression to determine cause and effect behaviour. For example, low interest rates affect demand for products in a market and increase the disposable income of purchasers. The Kahn Academy has information relating to regression analysis at: <http://aspirelr.link/khan-academy-quantitative-data>.

Example: sales forecasts

To view samples of sales forecasts and for guidance on developing forecasts for different businesses in a variety of industries, visit the following website:

- Queensland Government, Business and industry portal, 'Sales forecasts and targets', <http://aspirelr.link/sales-forecasts-targets>

Analyse the expenses budgets

There are two major categories of expenses: operating costs and capital expenditure.

Operating costs

The operating expenses, or expense forecast as they are commonly referred to, estimate an organisation's variable and fixed costs for the year or other specified period. Generally, costs are based on historical data and information, and projections should take into account market and industry research findings related to recent and potential changes in the Australian dollar and interest rates. For new products, costs need to include those required to produce and market the products, including new raw materials, new or more equipment and increased staffing levels. Managers need to review cost of goods sold (COGS) forecasts, inventory, production, labour and administrative expenses budgets to determine requirements.

Capital expenditure

Capital expenditure budgets are for assets that are deemed to be capital in nature and are used over many budgeting cyclical periods. They include plant, equipment, buildings and vehicles. The payment for assets is determined by dividing the cost by the number of years it will be in use within the business's operations. For new products, manufacturing companies may need to purchase new equipment, and the cost of this machinery for one year needs to be determined for inclusion in the cash budget.



Practice task 6

1. What is the formula to calculate an organisation's net cash position?

2. During the budget development process, when are qualitative methods more commonly used?

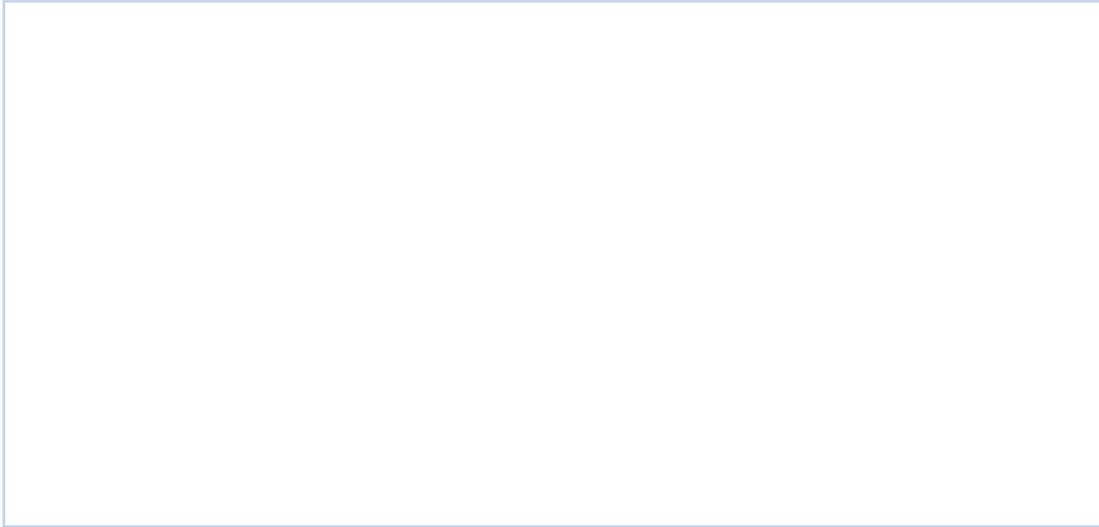
3. Conduct research into appropriate qualitative and quantitative forecasting methods.

- a) Provide two examples of qualitative analysis techniques or tools.
- b) Provide two examples of quantitative analysis techniques or tools.

continued ...

... continued

4. In preparing the expense budget, should the variable costs be excluded? Why or why not?



2C

Prepare the profit and loss and balance sheet budgets

A profit and loss budget, which is a summary of expected income and expenses, is a plan to guide an organisation's operational spending within a specified period. Managers often prepare their budget, sometimes referred to as an income budget, by reviewing previous financial statements and factoring in expected growth or information relating to new items. New businesses or those using the zero-based method alone will rely on the sales and expenses forecasts and area budgets. Profits and losses are then used to forecast and develop the month-by-month budget.

A budgeted balance sheet, which projects the balances of assets and liabilities, guides management decision-making. The budget enables managers to check the viability of other budgets by determining whether there will be enough cash to fund organisational activities. If the sheet reveals a weakness in cashflow, for example, an organisation might revise its capital expenditure plan.

Set the profit and loss budget

The process for setting the profit and loss budget is outlined below.

Profit and loss budget setting process

Review the sales forecast to determine the sales revenue, which is the expected units multiplied by their selling price.

Review the COGS forecast to determine gross profit margins.

Review the expenses budget to determine the net profit margins. Add in tax liabilities and interest payments.

Calculate the sales targets required to meet organisational objectives, which should be quantified.

Example: profit and loss budget

Many organisations develop the budget in the same format as the profit and loss statement for easy analysis of performance and to ensure compliance with statutory, legislative and organisational reporting requirements.

continued ...

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Profit and loss report for the year to 28 February 2016							
	Month-to-date		Year-to-date			YTD	2015/16 Budget
	Actual	Budget	Actual	Budget	Variance	Last Year	
	(\$ '000)	(\$ '000)	(\$ '000)	(\$ '000)	(\$ '000)	(\$ '000)	
TOTAL INCOME	13,174	12,495	98,620	101,526	-2,906	99,622	150,000
OPERATING EXPENSES							
Payment to suppliers	4,839	4,950	58,203	39,200	19,003	38,465	77,000
Salaries & on costs expenses	5,218	5,400	25,287	26,540	-1,253	22,657	46,000
Marketing & sales expenses	235	250	1,760	1,950	-190	1,498	3,000
Accommodation expenses	56	57	448	456	-8	430	672
Communication expenses	15	19	128	120	8	115	180
Governance expenses	36	36	288	288	0	270	432
Administration expenses	19	20	152	160	-8	145	240
Consumables expenses	15	16	144	120	24	140	180
Other staff-related expenses	16	18	136	152	-16	130	228
IT, repairs & equip hire expenses	21	20	182	170	12	178	240
Depreciation expense	375	362	2,960	2,910	50	3,120	4,365
TOTAL OPERATING EXPENSES	10,845	11,148	89,688	72,066	17,622	67,148	132,537
EBIT	2,329	1,347	8,932	29,460	-20,528	32,474	17,463
Interest on investments	186	180	1,192	1,160	32	57	1,788
Dividends on investments	0	0	23	22	1	19	52
Unrealised gains/ (losses) on investments	57	3	121	30	91	81	32
Profit (Loss) on sale of assets	0	0	65	0	65	0	0
Charity sponsorship	-30	-30	-240	-240	0	-200	-360
EBT	2,542	1,500	10,093	30,432	-20,339	32,431	18,975
Company tax	0	0	2,271	2,986	-715	2,798	5,693
Net income	2,542	1,500	7,822	27,446	-19,624	29,633	13,282

Develop the budgeted balance sheet

There are four major components to the budgeted balance sheet: accounts receivable, inventory, fixed assets and accounts payable. The process for setting the budget balance sheet is as follows.

Budgeted balance sheet process

Review the current balance sheet, area budgets and cash budgets.

Adjust the beginning balances of assets, liabilities and owner's equity accounts for forecasted activity during the period.

Identify issues in balances in current asset and liability accounts within the same period, and identify potential responses to issues.

Example: budgeted balance sheet

As with the profit and loss budget, the balance sheet budget is usually presented in the format of the balance sheet for later analysis.

Budgeted balance sheet as at 28 February 2016				
	2014/15 Actual at 30 June 2015	2015/16 YTD Actual	2015/16 YTD Budget	Variance
	(\$ '000)	(\$ '000)	(\$ '000)	(\$ '000)
BALANCE SHEET				
Cash & bank deposits	53,515	56,039	58,698	-2,659
Receivables	3,520	3,892	3,600	292
Inventories	23,680	32,120	25,600	6,520
Other current assets	2,468	2,698	2,500	198
Total current assets	83,183	94,749	90,398	4,351
Non-current investments	145,698	158,123	152,000	6,123
Plant & equipment	32,000	36,982	38,000	-1,018
Intangible assets	8,900	9,000	9,000	0
Total non-current assets	186,598	204,105	199,000	5,105
Total assets	269,781	298,854	289,398	9,456
Current liabilities	16,584	19,844	18,500	1,344
Non-current liabilities	897	985	980	5
Total liabilities	17,481	20,829	19,480	1,349
Net assets	252,300	278,025	269,918	8,107
Total equity	252,300	278,025	269,918	8,107

Example: extract of balance sheet

Current liabilities	
Trade creditors	2,330
Net GST payable	2,590
Sundry creditors	740
Unearned revenue	0
Annual leave provision	5,465
LSL provision - < 1 year	3,863
Salaries clearing	3,550
Group tax clearing	66
Superannuation clearing	1,240
TOTAL CURRENT LIABILITIES	19,844
Long service leave > 1 year	985
TOTAL NON-CURRENT LIABILITIES	985
TOTAL LIABILITIES	20,829

Practice task 7

Are the following statements true or false? Briefly explain your answer.

1. A cash budget, which is a summary of expected income and expenses, is a plan to guide the operational spending for an organisation within a period and is structured to enable variance analysis and to meet statutory reporting requirements.

2. The budgeted balance sheet comprises four components.

2D

Develop risk and contingency plans

All budgets should have risk and contingency plans to allow managers to make adjustments and help them respond to issues, new operational circumstances or possible identified financial risks. Potential risks to meeting budgets, for example, need to be identified, assessed and managed to enable an organisation to meet strategic or business objectives.

The first step in financial risk management is to identify the financial risks an organisation might face and how these would affect the budgets. Through the identification process, managers can implement possible risk controls and contingencies.

Identify internal and external operational risks

Possible risks and risk control measures are outlined below.

Equipment issues

Regular breakdowns add to the expenses budget. As noted earlier, maintenance can be incorporated into the budget. One control measure, when dealing with equipment failure, is to lease equipment.

Supply issues and costs

Materials not arriving or being held up at customs can hinder production and thus affect an organisation's cashflow. Price and cost changes, higher costs of inputs and unexpected salary increases add to the labour and production costs and thus cashflow. In these circumstances, options to control these increases may mean an organisation will need to hold greater quantities, which will incur a higher inventory (stock on hand) cost. Having more solid contractual arrangements in place with suppliers can reduce supply issues and costs.

Staff shortages

Sudden illnesses or departures of staff affect labour costs; managers need to pay other staff overtime to meet production schedules. In these situations it may be more financially viable to consider an increase in casual/flexible labour.

Quality control

Poor standard of products sent to market or incorrect advice to clients/customers will affect the supply and demand for goods and therefore income from sales.

Implementing better quality control measures within the production chain will help to lift the current standard of products and services being offered.

Environmental events and major disasters

Environmental events and natural disasters such as storms, floods, tsunamis, power failures, water shortages, drought, heat waves, fires, explosions and gas leaks affect the production of products and services. All organisations must have a disaster management/business continuity plan to manage these events.

Identify competitor, consumer and legal risks

Here are some more possible risks and risk control measures.

Competitor actions

The release of a new, better or cheaper product by a competitor will affect demand for goods and have an immediate effect on organisational income.

The marketing department needs to have strategies in place to ensure the organisation maintains its competitive edge and position in the marketplace.

Consumer behaviour

Satisfaction ratings or changes in consumer spending habits affect sales and cashflow.

The marketing department needs to have promotional strategies in place to ensure the organisation can respond to shifts in customer behaviour.

Political and legal issues

Changes in government/s may lead to changes in policy and laws affecting the way organisations operate. Tax increases, for example, can affect demand, sales and cashflow.

An organisation needs to have contingency plans in place to allow for potential increases in tax rates when forecasting sales, expenses and cashflow.

Theft and fraud

Mismanagement of resources, theft and fraud add to costs and affect cashflow and the financial bottom line.

Increased security measures and internal financial controls should be put in place immediately.

Assess risks

Managers need to identify the likelihood and impact of risks and current controls in place to address these risks. This may involve consultation across a broad range of areas that are external to an organisation. Contingency plans should be prepared to control the risk by reducing its likelihood (the chance the risk will occur) and/or reducing the impact (consequences or effects of the risk) if it does occur.

A risk assessment matrix can be developed and used to evaluate a risk, where likelihood and impact are identified to determine the level of the risk where these intersect on the matrix. High-level risks become priorities for immediate treatment or control. Moderate risks will need to be addressed over a brief time frame and require a management focus. Some low-level risks may be resolved through routine procedures.

Consider the likelihood and impact of an activity you have been involved with – relating to financial management – and use this matrix to determine the risk level.

L I K E L I H O O D	VERY LIKELY	Acceptable risk medium	Unacceptable risk high	Unacceptable risk Extreme
	LIKELY	Acceptable risk low	Acceptable risk medium	Unacceptable risk High
	UNLIKELY	Acceptable risk low	Acceptable risk low	Acceptable risk medium
		MINOR	MODERATE	MAJOR
		IMPACT		

Identify risk controls

In managing risks to finances, undertaking regular risk analyses and preparing a risk management plan are critical to the financial success of any organisation.

Examples of risk controls
<ul style="list-style-type: none"> • Outsourcing of operations or activities, such as payroll or advertising, to transfer the risk to another organisation • Diversifying outcomes by increasing the range of products to reduce the reliance on a small range of products and services • Using cheaper raw materials and consumables, and ensuring there are alternative suppliers available to provide materials on an ongoing basis • Adjusting resources to provide increased effectiveness and efficiencies, including buying new equipment or increasing staff numbers • Identifying areas of wastage/shrinkage and reducing costs related to the number of staff that travel, for example • Seeking funding through loans, issues of shares or grants, depending on the type of organisation • Providing training and development to ensure continuity of management and employees and to reduce the costs of staff retention

Prepare contingency plans

A contingency plan, or contingency response, outlines the actions required by managers following a trigger to an identified risk. A trigger creates the circumstance under which a contingency strategy needs to be implemented. This may be the result of a risk control measure failing or due to a major catastrophe that is not covered in existing organisational disaster management plans. A contingency response is identified and developed in much the same way as a risk treatment or control measure and is documented accordingly.

Example: contingency plan

A manufacturing firm that specialises in the construction of stainless steel fabrication bought a new sheet metal press and installed it for use. As a contingency, the old sheet metal press was not decommissioned, but placed into storage in the event that the new machine failed. After five weeks of operation, the new machine had a major failure with a hydraulic connection that would take three weeks to repair. The old press was reinstated after four hours and, though slower, it was able to maintain production at an acceptable level to meet targets.

Practice task 8

1. Following an analysis of financial information, what should be determined to identify the risk level?

2. Why do you think triggers are a critical element of a contingency plan?

Summary

1. The budgeting process involves the preparation of budgets for all areas of activity within an organisation using approaches and methods outlined in an organisation's budgeting policy and procedures. It is these area budgets that provide the detail for developing an organisation's cash budget, profit and loss budget, and balance sheet budget.
2. The cash budget, which predicts the cash inflows and allocates cash outflows and relies on effective cashflow forecasting, aims to ensure that an organisation will have the working capital required to meet its daily activity costs.
3. A profit and loss budget is often prepared by managers reviewing previous financial statements, factoring in expected growth or information relating to new items. Profits and losses are then forecast by relevant managers to develop the month-by-month budget.
4. A budgeted balance sheet enables managers to check the viability of other budgets by determining whether there will be enough cash to fund organisational activities.
5. The first step of the financial risk management process is to identify the financial risks that an organisation might face and how these would affect the budgets. Following the assessment of risks, managers can identify possible contingencies.
6. Contingency plans need to be developed to respond to issues or new circumstances that will affect an organisation's ability to meet strategic or business objectives.

Learning checkpoint 2

Establish budgets and allocate funds

This learning checkpoint allows you to review your skills and knowledge in establishing budgets and allocating funds.

Part A

1. Explain the relationship between zero-based budgeting, resource allocation and the estimate of new items for inclusion in budgets.

2. When would you review the cost of goods sold (COGS) forecast to determine gross profit margins?

3. What would you review during the profit and loss budget setting process to determine net profit margins?

Part B

In this section you are required to consider the establishment of budgets for your organisation, or one that you are familiar with. This may be an organisation that you have previously worked for or one that you are in close contact with, such as your training provider, a not-for-profit organisation that you volunteer for, or a sporting or social club.

1. Does the organisation take a top-down or bottom-up approach to budgeting? Refer to the budgeting policy, procedures and/or guidelines to determine why the organisation takes this approach. If you are unable to access this information, consult the general manager or finance director.

2. Document the organisation's process for developing the cash budget in accordance with statutory and organisational requirements. Include in your process those who are involved in, and methods of collaboration for, setting budgets.

3. Imagine there are rumours that the company tax rate will increase from 30 to 33 per cent. Consider the impact of such an increase on the organisation's cashflow.
- a) Identify whom you would consult with to consider implications and develop controls.
 - b) Rate the risk, using the risk assessment matrix, and identify the level. Explain the reasons for the level.
 - c) Identify a measure to control the risk.
 - d) Identify a contingency response and explain the reason for the selected trigger.
 - e) Explain how you would ensure the budget is revised to take the change into account.



Topic 3

Implement budgets

Managers working within organisations need to have the relevant information from budgets so they can perform their duties appropriately and make informed decisions when implementing budgetary requirements. Those in charge of budgets need to ensure that activities to meet budget objectives are carefully managed to ensure risks related to fund misappropriation are avoided or treated immediately. This usually requires the implementation of internal and external controls, which includes ensuring audit trails are maintained and that organisations comply with due diligence obligations. Furthermore, as the future financial standing of an organisation can only be predicted, performance needs to be monitored and revised to allow for contingencies. Monitoring involves the review of actual performance against budgeted performance.

In this topic you will learn how to:

- 3A Circulate budgets to managers and supervisors
- 3B Implement controls to minimise risk of improper financial behaviour
- 3C Determine budget variances and manage contingencies

3A Circulate budgets to managers and supervisors

Once budgets are prepared and approved, they should be provided to senior management, relevant managers and supervisors. Their teams should then have the opportunity to look at the relevant budget's details and determine how it will affect their day-to-day duties. Budgets should also be checked by lower-level managers and team leaders to ensure their earlier inputs, generally via area and team budgets, have been taken into account in the finalised master budget.

The budgeting leader may hold a meeting to communicate the details and responsibilities for managing finances. Alternatively, the budget may be circulated throughout the organisation, providing comprehensive instructions on implementing variable financial controls within the different areas of the business. How budgets are circulated will depend on the size of the organisation, the location of business units and the organisation's policies, procedures and implementation protocols that underpin the control of budgetary requirements.



Circulation methods

When disseminating budgets, you will need to take into account the location of managers and supervisors and your organisation's communication policies. For example, face-to-face meetings and presentations may not be appropriate when managers are located at overseas, interstate or regional sites. However, information sessions may be possible via video conferencing, Skype and FaceTime.

Circulation methods include:

- formal meetings – where the recipients are identified and presented with specific budgetary information relevant to their roles and responsibilities
- group meetings/sessions – where a specific focus is required and those attending have a common area or linked activity
- written communication – where the information is sent via paper-based letter or report
- face-to-face presentations – where an audience can be selected and videoconferencing may be used
- electronic communication – where emails are sent to individuals or groups, or documentation is made available on the wiki or intranet.

Use active listening techniques

When financial information is circulated, it should be clear and easy to understand. This is to ensure each person is aware of the organisation's requirements and of their responsibilities in managing finances. Managers need to ask and encourage questions from departmental and area teams to check for understanding of the content and approval of the budgets. Their responses and concerns need to be raised and addressed in a timely and appropriate fashion.

Consider the information requirements

Managers and supervisors need to have the finalised and approved budgets for their areas made available to them, given they require the information to manage their areas or departmental financial responsibilities. Managers and supervisors need to be made aware of the organisation's policies, procedures and guidelines for allocating funds to tasks and monitoring the actual spending against proposed budgetary requirements. Managers need to know who to provide the relevant information to and when, to ensure the organisation meets its ATO, ASIC, ASX, APRA or any other financial reporting obligations.

Example: budget circulation

Kathy is the CEO of a giftware company that sells its products to a wide range of retail outlets, both locally and internationally. The CFO, Isaac, is responsible for the master budget development and production of a draft organisational budget based on the draft budgets submitted from each department within the organisation. On Isaac's recommendation, Kathy approves the draft master budget for the organisation.

Kathy then addresses all departmental managers about how the organisation's various strategic objectives have been emphasised and incorporated into the approval process of the draft budgets. At the same meeting, Isaac presents the details of the master budget to the departmental managers.

A further series of meetings is held with departmental managers and the person responsible for their draft budgets manages their circulation over the next few days. Work teams that have been involved in budget preparations are briefed by Isaac and the relevant departmental management team. The following week, each departmental manager disseminates the agreed and approved budgets to their work teams.

Kathy and Isaac publish a statement via email to all staff and on each department's wiki website so all staff are aware of the organisation's budget position and broad plans for the forthcoming financial year.



Practice task 9

Explain why it is essential that budgets are clearly explained to all staff, and why managers must use active listening techniques to do so.

3B Implement controls to minimise risk of improper financial behaviour

Effective internal controls – such as internal and external financial systems and regulated organisational policies and procedures – will ensure that financial recording mechanisms, transactions and statements are accurate and not at risk of exposure to the misappropriation of funds and/or discrepancies. Compliance with due diligence obligations will help an organisation prevent improper financial behaviour.

Define 'misappropriation of funds'

The misappropriation of funds falls under the category of fraud and is illegal under various Commonwealth, state and territory crimes Acts. Misappropriation fraud refers to an employee or director abusing their position within an organisation to steal funds belonging to the organisation through fraudulent workplace activity. The information below shows some examples of misappropriation and a description of how fraud is regulated.

Examples of misappropriation

- Fictitious claims expenses
- Misuse of expense accounts for personal use
- Payments to fictitious suppliers
- Theft of cash meant to pay for organisational bills
- Theft of funds from the superannuation trust
- Falsified payroll records where unworked overtime is claimed or ghost workers are paid

Regulation of fraud

Corporate fraud in Australia is governed by:

- rules under the Corporate Law Economic Reform Program (CLERP 9)
- rules outlined in the Australian Auditing Standard, (ASA) 240: The Auditor's Responsibility to Consider Fraud in an Audit of a Financial Report, relating to the transparency in accounting and reporting, and accountability, by making board members and executives personally responsible for financial reports.

Identify areas at high risk of misappropriation and discrepancies

The assessment of risk process can be applied to the specific areas of funds misappropriation and discrepancies, with a focus on identifying areas of high risk and identifying what controls need to be implemented to prevent future financial misappropriation. Many of these controls relate to maintaining an audit trail, which also helps to manage non-fraud-related discrepancies and errors.

The following information outlines key risk areas where misappropriation and discrepancies may occur.

Funds high-risk areas

- Cash handling where staff are handling cash received from customers or petty cash
- Purchasing areas where staff can raise false invoices to be paid to ghost suppliers, and where accounts can be worked to make false payments
- Payroll where staff might claim unworked time, including overtime, and make claims for non-work related expenses
- Unrecorded sales where products are provided and the cash is received but not entered through the point of sale (POS)
- The recording of fictitious sales for staff to receive commission
- Sales where there is regular write-off of receivables, falsely voided transactions, fictitious refunds and unauthorised discounts

Discrepancies risk

Systems to ensure the accuracy of data and financial information need to be in place because discrepancies and errors will and do occur. It is vital that you can identify these and rectify them or refer them to the appropriate person. Examples include:

- recording the wrong figure amount in records, such as placing the decimal point in the wrong place
- coding to the wrong asset account
- absence of an auditable trail where invoices are not raised to make payments
- inappropriate authorisation of funds
- expenditure report mismatches
- incorrect payments
- incorrect report formats
- unreconciled cashflows and statements
- variances from budgets.

Implement financial risk policy

The following policies may be implemented in an organisation to establish a control framework for financial control, including fraud. The policies will depend on the nature of the organisation and its financial reporting systems and requirements.

Organisational financial risk policies may include:

- external financial reporting to ensure compliance with ATO, ASIC, ASX and/or APRA regulations
- financial review and analysis policies outlining who should be involved, what should be reviewed and the frequency of analysis
- financial transaction recording to outline requirements for the appropriate recording of transactions to ensure an audit trail is maintained

- audit policy on the frequency of the external audit, how auditors should be appointed and how information will be provided to auditors
- fraud control policy defining fraud and identifying strategies to control fraud.

Implement control measures

Organisations must have a strong set of measures to ensure the handling, checking and authorisation of financial information is done accurately. An audit trail must be evident, whereby financial transactions can be identified and linked to their source documents, such as receipts, invoices and purchase orders. The organisation's accounting system should include measures, including the generation of an audit trail report, that will minimise the possibility of errors, prevent fraud and promote financial efficiency.

Internal control procedures may include:

- separating duties so that the tasks performed by one employee are checked by another; for example, the separation of ordering and invoicing
- ensuring there is regular reconciliation of accounts and ledgers
- ensuring that the receiving, recording and banking of cash are not performed by just one employee
- ensuring that employees have the appropriate skills to perform the tasks required by providing training and development opportunities
- implementing a system of authorisation; for example, a manager to authorise purchases over a certain amount
- ensuring that all business documents are pre-numbered so all documents are accounted for, thus minimising the possibility of fraud
- regularly changing passwords to prevent non-authorised access to information, accounts and reports
- making sure regular audits are performed
- implementing a code of ethics to promote appropriate behaviour.

Compliance with due diligence obligations

Due diligence refers to the process of validating information related to all areas of the organisation to help manage financial risks. Due diligence may be provided by parties external to the organisation, and is often conducted by purchasers before the final sale of businesses. Some organisations will conduct due diligence to pre-qualify suppliers of services, products and raw materials. However, every reporting entity organisation (those required to prepare external reports for government agencies, investors and members) has due diligence obligations.

Here is some information on what due diligence involves and the obligations associated with it.

Due diligence obligations

- Director duties, responsibilities and reporting requirements under the *Corporations Act 2001* (Cth).
- Transaction monitoring, and owners and customer information collection and validation (customer due diligence) requirements under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth).
- Provision of information about accounts maintained by US tax payers to the ATO under the *Tax Laws Amendment (Implementation of the FATCA Agreement) Act 2014* (Cth) to combat offshore tax evasion.

Financial due diligence

A financial due diligence review involves:

- consideration of the organisation's historical financial performance and current financial position through financial report analysis
- consideration of the forecasted financial performance under the current business plan and its ability to meet objectives
- identification of trends and investigation of the reasons for shifts in performance
- consideration of the management of risks
- ensuring tax obligations are met and the identification of potential tax consequences on the organisation's activities.

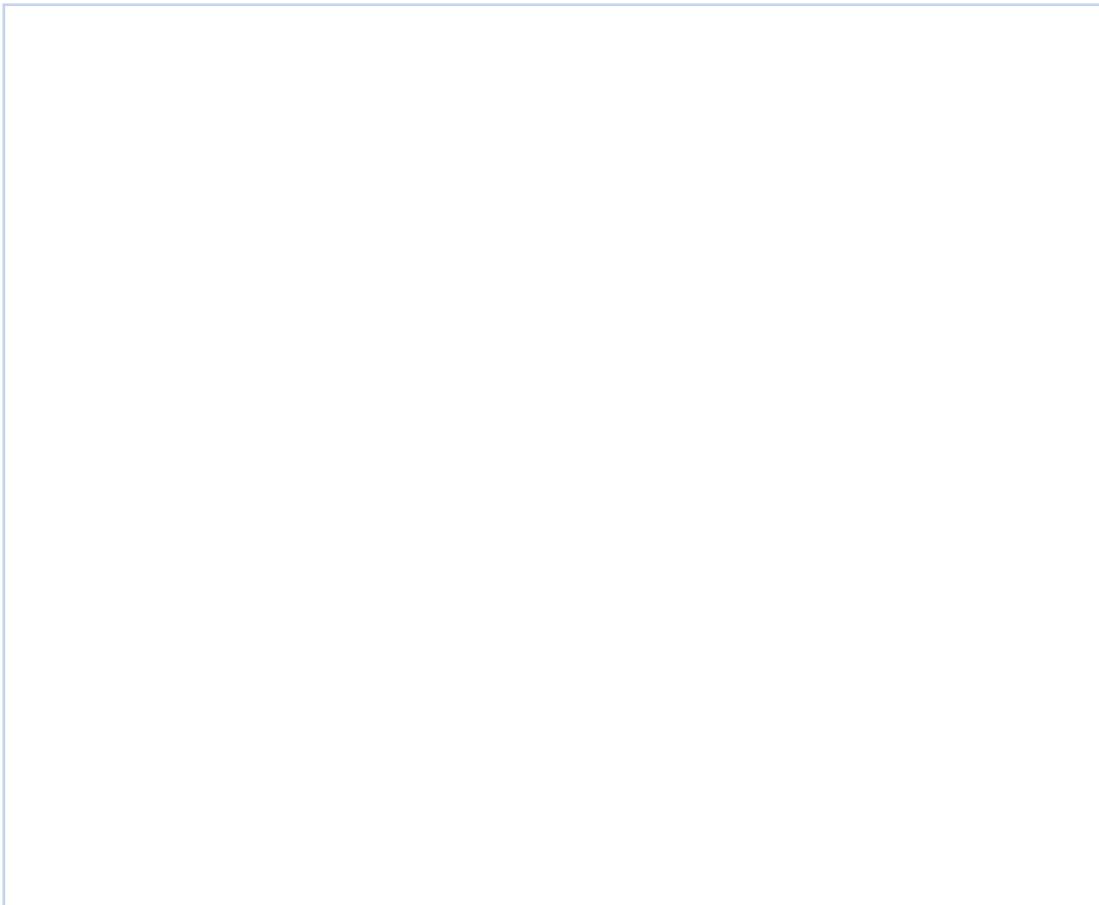
Practice task 10

1. Why is maintaining an audit trail a critical internal control measure?

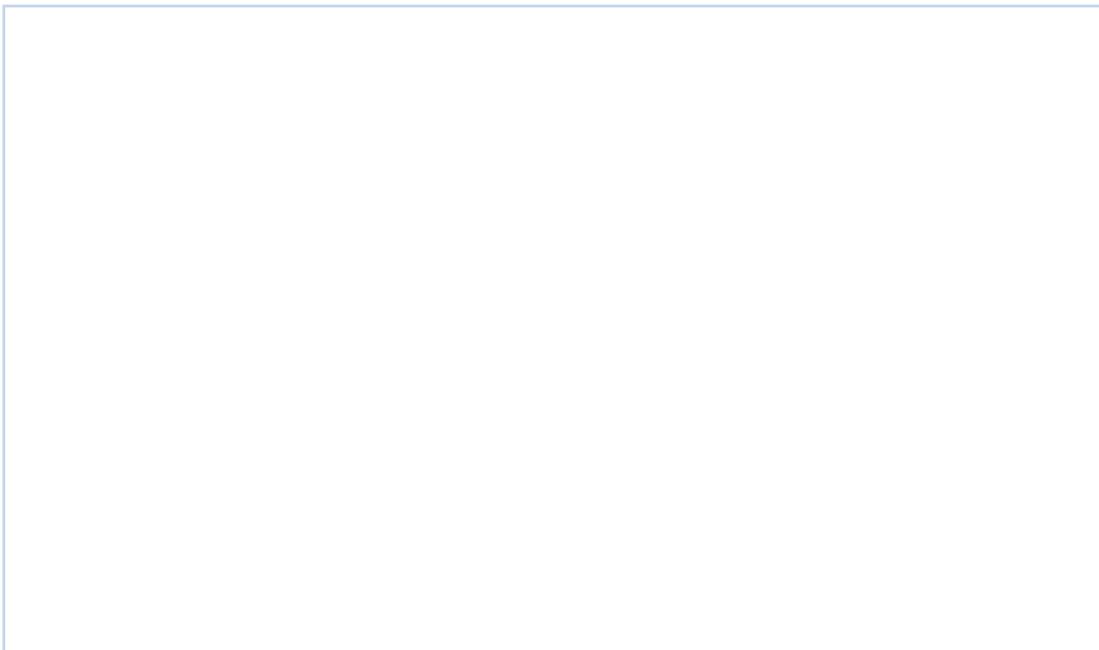
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2. Conduct research on 'due diligence'. Explain the difference between supplier due diligence and customer due diligence.



3. Explain the value of supplier due diligence in managing procurement risk.



3C

Determine budget variances and manage contingencies

Monitoring financial projections against actual results on a monthly basis helps ensure financial control and helps to identify where adjustments are required to manage gaps or where contingencies should be implemented to manage issues. The comparison between what was budgeted and actual information will reveal the variance to determine the action required to improve performance to meet organisational objectives.



Review profit and loss reports

A review of an organisation's profit and loss report can help identify variances and supports the determination of issues in meeting the organisation's objectives.

Questions to ask when considering reasons for variance

- Is there an unfavourable variance in sales – does it suggest a trend and the potential that the organisation won't shift products at current prices?
- Is there a seasonal issue, such as Christmas, affecting the favourable result in sales?
- Are clients not paying at the expected times? What does the cashflow look like and how can cash be increased?
- Have rising prices affected expenditure performance? If so, can cheaper materials be sourced?
- Is an increase in customer demand from successful promotional activities the reason for a favourable variance in sales?
- What do favourable variances in sales mean for purchasing and production?
- Have equipment failures resulted in unfavourable variances in costs? Does the capital equipment budget need to be adjusted to reflect this?

Example: profit and loss variance report

Here is an example of an aggregated report, which suggests that this business is doing quite well. Sales are up five per cent on budget. Direct materials are lower than budget by 11 per cent, and direct labour costs are down 22 per cent on budget. Overheads are also lower than the budgeted amount. The net result in terms of profit is very favourable (F).

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Report on performance for November 2015			
Item	Budget (\$)	Actual (\$)	Variance result
Income			
Sales	110,000	115,500	5,500 F
Expenditure			
Direct materials	45,000	40,000	5,000 F
Direct labour	48,500	38,000	10,500 F
Overheads	3,500	(2,000)	5,500 F
Subtotal	97,000	76,000	21,000 F
Profit	13,000	39,500	26,500 F

The following table is used to consider if the variances are favourable (F), unfavourable (U) or within expectations (OK).

Area	Budget (\$)	Actual (\$)	Variance result
Income (sales)	X	More than X	F
	X	Close to X	OK
	X	Less than X	U
Expenditure (costs)	Y	More than Y	U
	Y	Close to Y	OK
	Y	Less than Y	F

Generally there is an acceptable level of variation, either a fixed amount or a percentage. In this way, managers won't spend too much time looking at a \$5 variation in an item listed at \$1,500.

Review cashflow and summaries reports

A review of the cash budget will help managers to assess working capital needs and to make changes to the budget before decreased cash affects the organisation's ability to conduct its activities. As with the profit and loss budget, the cash budget variances can be determined by comparing differences between the budgeted cash required for a month and the actual cash position for the month.

By reviewing the accounts receivable ageing summary, managers can identify what cash the organisation can expect from customers, usually within a period of several months. The summary reports the length of time invoices have been outstanding. If customers are slow in paying, credit management procedures will need to be implemented and the risk of late-paying customers assessed. This may also be a sign that the product demand or business is slowing. The accounts payable ageing summary reveals what cash needs to be paid within a few months. If the organisation is letting bills slip beyond payment dates, then cash may need to be sourced.



Example: statement of cashflows

The report below illustrates a statement of actual cashflows with projected forecasts.

Statement of cashflows as at 28 February 2015 and forecast to June 2015						
	YTD 2014/15	Actual February 2015	Forecast			
			March	April	May	June
	(\$ '000)	(\$ '000)	(\$ '000)	(\$ '000)	(\$ '000)	(\$ '000)
Receipts	102,354	11,296	7,935	6,801	7,935	9,069
Total receipts	102,354	11,296	7,935	6,801	7,935	9,069
Payments to suppliers	57,682	4,923	3,921	2,755	3,667	3,839
Payment to employees	23,581	5,295	3,376	3,515	3,648	4,522
Capital purchases	18,567	103	989	96	45	121
Total payments	99,830	10,321	8,286	6,366	7,360	8,482
Cash inc/(dec)	2,524	975	-351	435	575	587
Cash at the beginning	53,515	56,039	57,014	56,663	57,098	57,673
Cash held	56,039	57,014	56,663	57,098	57,673	58,260

Implement controls and contingency plans

The risk and internal controls and contingency plans developed as part of a budget process may need to be implemented to correct unfavourable budget variances, contingency triggers and the possible failure of identified internal risk controls.

Here are some examples of contingency triggers and their control measures, which can be used following the failure of internal and identified risk controls.

Cashflow issues

- Ageing summaries analysis reveals that a regular client is not paying on time.
- Risk control: Institute credit recovery procedures.
- Contingency response: Cease business with the client.

Increased costs

- └ Cost analysis may indicate that specific organisational costs are beyond their maximum budgeted limit.
- └ Risk control: Restructure HR department processes to improve efficiency.
- └ Contingency response: Outsource some functions; for example, recruitment functions.

Sales decrease

- └ Sales volume and unit analysis indicates a decrease in sales of a specific product.
- └ Risk control: Production may be increased or decreased; price analysis identified the need to reduce selling price.
- └ Contingency response: Cease production and marketing of the product.

Supply issues

- └ A supplier can no longer supply the materials required because they have gone out of business.
- └ Risk control: Identify another preferred supplier.
- └ Contingency response: Cease production of the product.

Funds misappropriation

- └ Reconciliation and analysis reveal that false invoices are being raised and payments made against them.
- └ Internal controls: Segregation and/or possible re-design of employee duties and authorisation process.
- └ Contingency response: Commission an external audit of controls and develop more stringent processes.

Change in legislation

- └ A new reporting requirement as a result of a change in law has resulted in an increase in expenses.
- └ Risk control: Adjust budget overheads and implement system efficiency measures to manage organisational obligations.
- └ Contingency response: Source loan to deal with short-term working capital issues and outsource functions.

Monitor internal controls, risk and contingency plans

The implementation of internal controls and risk or contingency plans may result in changes to budgets – so budgets must be adjusted accordingly. To ensure these controls and risk or contingency plans are effective in correcting issues, they will need to be regularly monitored and adjusted by conducting ratio and variance analyses to assess their performance.

Appropriate analysis techniques in addition to variance analysis on budgets may need to be considered. Should the analyses indicate failure of the control or plan in resolving issues, then further controls need to be implemented.

Risks should be reassessed and treatment strategies developed and implemented immediately. For serious issues, the organisation may need to consider obtaining the assistance of external experts and undertaking corrective actions to raise funds to increase current working capital.



Example: implement and monitor contingency plans

At Margo's Pasta, a medium-sized food-processing manufacturing plant, sales have dropped because the regulations relating to the importation of fresh sauces have been relaxed. An importer has introduced a new pesto sauce to the market that is in direct competition with Margo's Sauce, its leading product. The budget variance reports indicate that Margo's Pasta is not going to achieve the budgeted targets for the year. Furthermore, there is an excess of the product in the warehouse. The organisation's first contingency plan is to increase marketing strategies for the product and have sales representatives promote it heavily to customers, but after two weeks there is no sign of a significant increase in orders.

The second contingency plan is to again promote the product but at a discounted price, in an attempt to increase orders and therefore boost sales and reduce waste. Sales representatives contact the buyers with the offer. Sales increase and the impact of a competing product decreases. The budgets need to be revisited to accommodate the change in price and the effect this will have on the product's profit margins.

Practice task 11

1. What measures might you implement to address unfavourable profit and loss variances as a result of the increased expense associated with increases in the company tax rate?

continued ...

... continued

2. What measures might you implement if your analysis of the payables ageing summary identified that the organisation is consistently late in paying bills?

Summary

1. Approved budgets need to be provided to relevant managers, supervisors and teams to ensure that staff understand the details of the budget, the impact on their activities, and their responsibilities and levels of accountability for ensuring the organisation meets its objectives and statutory requirements.
2. The methods for circulating budgets depend on the size of the organisation, the location of business units, and the organisation's policies and procedures in implementing and controlling budgets.
3. Effective internal controls limit the organisation's risk of exposure to the misappropriation of funds and minimise discrepancies.
4. An internal control system includes policies and procedures to ensure the accurate recording of financial transactions and reporting of financial statements, and internal control measures.
5. Monthly budget monitoring and analysis helps ensure financial control and enables managers to identify where adjustments are required to implement contingency plans to bridge performance gaps.
6. The comparison between budgeted and actual performance information will reveal the variance to determine action to improve performance to meet organisational objectives.

Learning checkpoint 3 Implement budgets

This learning checkpoint allows you to review your skills and knowledge in implementing budgets.

Part A

1. What is an audit trail and why is it critical that it be maintained?

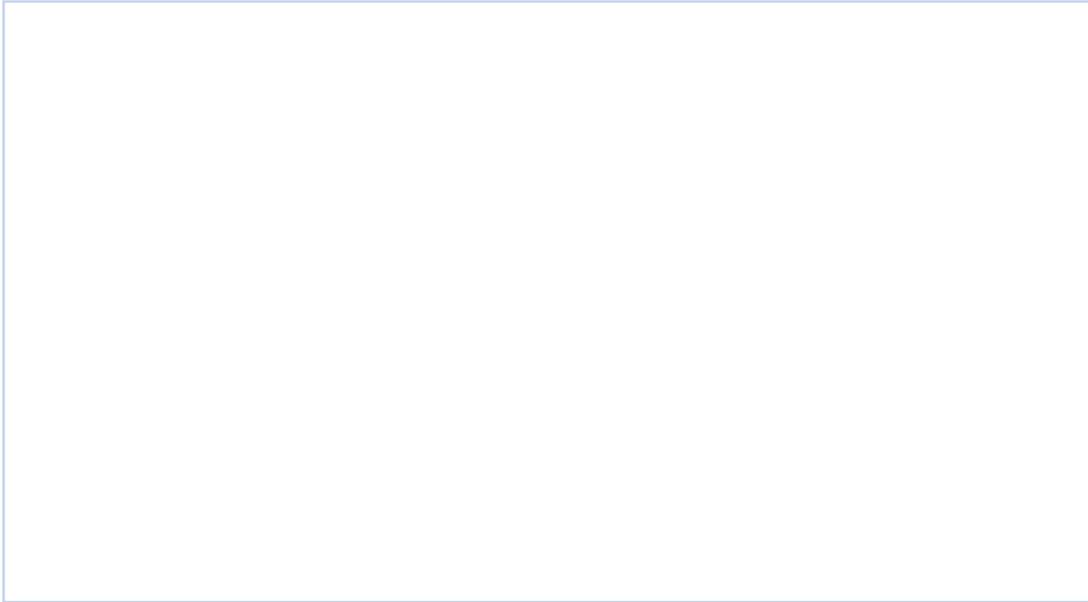
2. Why is it critical to conduct variance analysis of budgets on a monthly basis and to report this analysis, according to financial reporting requirements, to senior decision-makers?

3. What will a review of the organisation's accounts receivable ageing summary enable managers to identify? Why is this important?

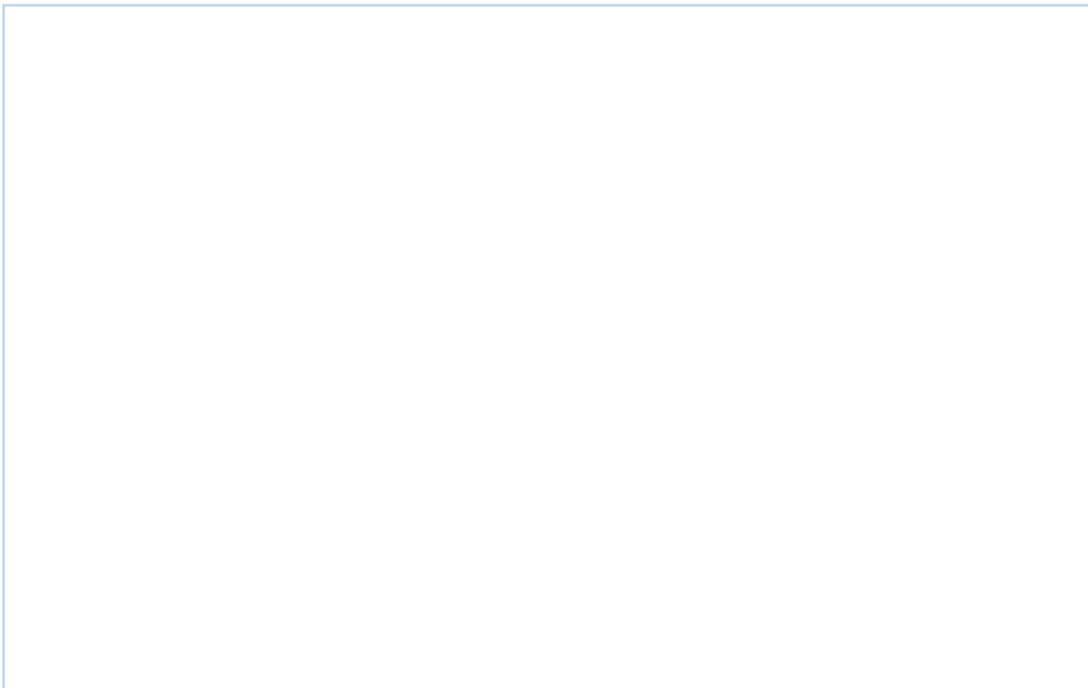
Part B

In this section you are required to consider the implementation of budgets for your organisation, or one that you are familiar with. This may be an organisation that you have previously worked for or one that you are in close contact with, such as your training provider, a not-for-profit organisation that you volunteer for, or a sporting or social club.

1. Document the budget circulation process and identify the methods and communication techniques you would use in the process. Consider using a diagrammatic approach to demonstrate it, such as a flow chart.

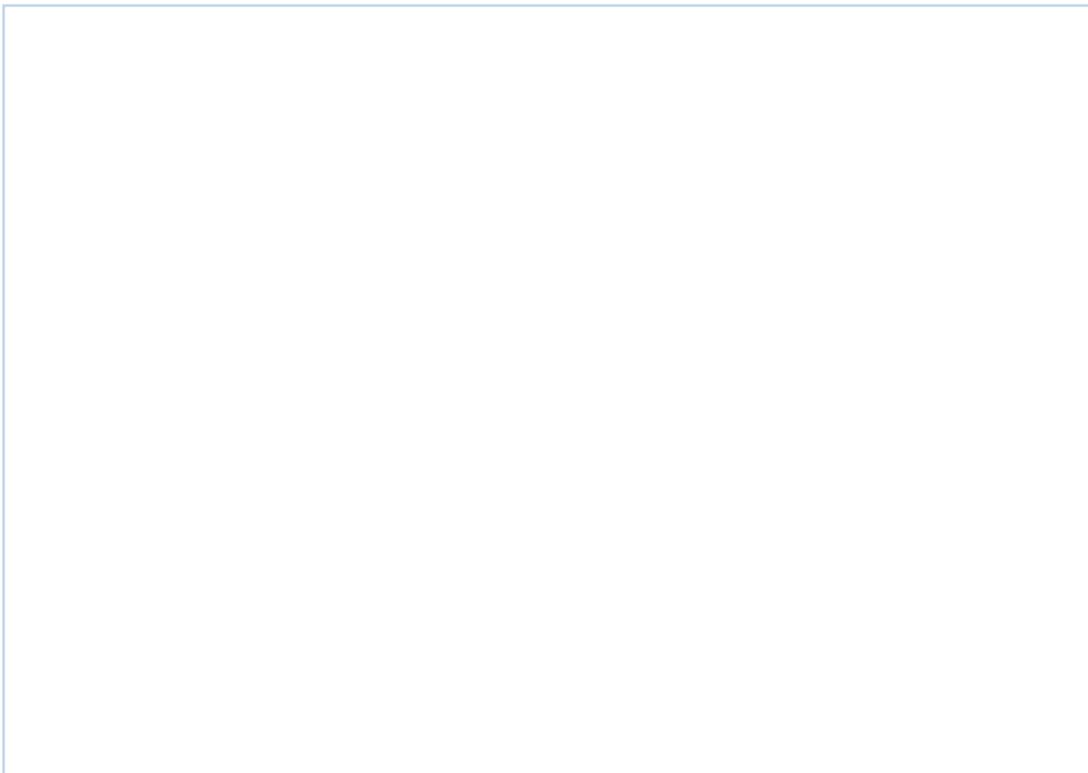


2. Review the organisation's internal control measures.
 - a) Outline the organisation's internal control measures for minimising the risk of funds misappropriation and discrepancies.
 - b) Explain how the measures comply with relevant statutory requirements.





3. How would the organisation manage unfavourable variances in the cash budget as a result of a major client regularly paying their invoices late?



Topic 4

Report on finances

This topic covers areas of financial reporting and control that are paramount components in an organisation's financial success. It is essential that internal and external reporting practices are appropriate to the needs of the stakeholders and enable management to make concise decisions to ensure all external agencies' requirements are being met. The main part of the control process is to ensure that financial protocols meet organisational objectives and that the financial management practices are effective, relevant and compliant with statutory and legislative requirements.

In this topic you will learn how to:

- 4A Ensure reporting conforms to requirements
- 4B Prioritise significant issues and prepare recommendations
- 4C Evaluate the effectiveness of financial management processes

4A

Ensure reporting conforms to requirements

Financial reports and recommendations must be accurate to effectively and successfully guide an organisation's operational activities. They must also comply with organisational policies and procedures and statutory regulations in terms of content and format. These statutory requirements often provide the basis for an organisation's reports and can be generated through the use of accounting software, with reporting structures developed and components customised to enable the effective and efficient reporting of results to senior management, owners, shareholders and agencies.



Managers need to be familiar with the required formats for balance sheets, cashflow statements, electronic forms, financial year reports, operating statements and statutory forms. An organisation's business management and accounting software generally has statutory compliant structures and formats for reports.

Present financial statements

How financial statements are presented is generally prescribed by the overall requirements for each statement, which will influence the structure and the minimum requirements for content. The accrual basis of accounting and the current/non-current distinction will need to be explained. A set of financial statements **MUST** comprise a statement of an organisation's financial standing and a statement of any changes of financial equity, including a statement of cashflow and other organisational incomes.

Further information relating to the presentation of financial reports is included in the 'AASB Standard 101 Presentation of Financial Statements', which is available at: <http://aspirelr.link/presentation-financial-statements>.

Identify reporting format requirements

Financial reports can be lodged with a variety of government agencies via Standard Business Reporting (SBR) enabled software, which is designed to work with business management and accounting packages. Organisations complete their financial statements and reports and attach electronic copies of these in PDF format. The lodgement of reports uses the eXtensible Business Reporting Language (XBRL). It is imperative that any files attached to the lodgement do not contain any active or encrypted content.

For information on Standard Business Reporting, which is an Australian Government initiative, visit the website at: <http://aspirelr.link/standard-business-reporting>.

Example: appropriate financial reports

Ravi is the manager for a major business unit with a turnover of more than \$30 million a year, in an organisation that turns over more than \$200 million. He prepares a monthly variance analysis and provides a report on any variations to his general manager.

Ravi provides a comment against any variation in the report. Where significant variances have been identified, he researches the situation and makes recommendations on contingency plans that could be considered for continuous improvement purposes.

Ravi also undertakes a trend analysis so he can consider the income and expenditure over the preceding months to determine whether there is a developing trend. If appropriate, he also compares each month's financial position against year to date (YTD) data.

The general manager must be able to access the findings in Ravi's report two days after the release of the variance reports to ensure the information is included in the organisation's financial reports and to meet taxation obligations and ASIC requirements.



Example: versions of financial reports

As permitted through Australian freedom of information protocols, you can access the annual reports and financial statements of a range of well-known Australian organisations. The websites demonstrate how different organisations format different reports and provide an overview of their financial summary statements.

Here are some examples:

- BHP-Billiton: <http://aspirelr.link/bhp-financial-results>
- World Vision, Annual Reports & Reviews page: <http://aspirelr.link/world-vision-annual-reports>
- Telstra, Reports and Presentations page: <http://aspirelr.link/telstra-financial-results>
- Virgin Australia, Annual Reports page: <http://aspirelr.link/virgin-annual-reports>

Practice task 12

1. According to the 'AASB Standard 101 Presentation of Financial Statements', what is the purpose of a supporting note?

2. Access the Standard Business Reporting website at: <https://aspirelr.link/standard-business-reporting>, then explain what the Australian Reporting Dictionary is.

4B Prioritise significant issues and prepare recommendations

Identifying significant issues from the analysis of the financial statements is a major part of providing financial business recommendations. For example, the organisation may experience consistently low profit margins or unfavourable cashflow variances. Two techniques can be deployed when significant issues within financial statements are identified: a budgetary variance analysis and the horizontal analysis method.

The analysis of an organisation's financial statements through ratio analysis helps managers to make recommendations to senior management based on the organisation's past performance and actual to budgeted performance in the current period. This analysis, along with internal controls and contingency plans, will help to identify areas to improve its financial position.



Prioritise significant issues

Managers can prioritise the significant issues by starting to consider their impact on achieving organisational objectives and using risk management principles to plan responses. Managers should involve other affected managers in the process, using active listening and brainstorming to generate ideas and solutions.

The process for prioritising significant issues is outlined here.

The prioritisation process

Consider whether the issues are linked or related in some way. How will they affect one another? For example, what is the impact of a price increase in line with inflation on sales?

Identify the underlying issues. For example, are expenditure increases the result of increases in prices of raw materials or labour costs?

Assess the likelihood of the issue affecting activity. Is there an immediate effect on activity? If the organisation doesn't immediately respond to the issue, what will the consequence be? Which areas will be affected?

Assess the impact of the issues. For example, if cashflow is an issue, what is the impact of paying suppliers for raw materials late? Will suppliers put a hold on the organisation's account?

Use a risk matrix to rate the issues. Issues with an extreme rating need to be treated or corrected immediately.

Develop recommendations

The recommendations developed must ultimately be aimed at improving an organisation's effectiveness and financial operations by addressing the core or underlying issues. These recommendations should be considered in light of internal implemented control measures and prepared contingency plans. The role of the financial analysis performed is to provide the evidence for the recommendations or contingencies developed.

Evidence that supports financial recommendations includes:

- budget analysis to support recommendations to increase investment or identify credit management actions to increase cashflow
- forecasts and estimates to justify increases in production to meet increased demand
- order and supply documents to identify patterns or market trends to support new product development and price change decisions
- ratio analysis to recommend particular investment pathways
- margin, break-even and return on investment analyses to prepare bids for new contracts (proposals or government tendering)
- taxation and statutory returns (in an audited annual report) to encourage shareholders to purchase more stock.

Practice task 13

Rewrite the following steps used in the process for prioritising statement issues in the correct order:

- Identify the underlying issues with team/relevant others through brainstorming
- Consider whether the issues are linked or related in some way
- Assess the impact of the issues
- Assess the likelihood of the issue affecting activities
- Use a risk matrix to rate the issues for priority

4C

Evaluate the effectiveness of financial management processes

Financial management processes must be regularly reviewed for an organisation to remain competitive and profitable. New or better processes need to be identified, implemented and monitored to ensure an organisation continues to achieve its financial objectives and meet statutory requirements. Some organisations have internal audit specialists or engage external ones to review their practices in areas not only related to financial management, but also to supply chain and ethics.

For many organisations, the focus is on reviewing and improving internal financial controls. This is to ensure efficiency in financial reporting and compliance with laws and organisational policies. Internal controls underpin financial probity and the protection of an organisation's financial resources, including cash and assets. Improving controls will increase the efficiency and effectiveness of financial management processes to enable an organisation to achieve its objectives.



Plan an evaluation process

An evaluation program or process is used by an organisation as a systematic strategy to enable it to collect and analyse financial data and to assist in identifying the effectiveness and efficiency of underpinning financial policies and procedures.

The following approach outlines the steps in evaluating financial management processes.

The evaluation process

1

Plan the evaluation

- Identify the participants in the evaluation process.
- Identify criteria to guide the development of checklists and time lines.
- Select the techniques and tools to be used in the review, such as mapping the processes, review of policies and procedures relating to processes, interviewing those involved in the processes to determine actual practice, and comparing actual practice to procedures.
- Identify the information requirements and who will source policies, procedures and other relevant information to perform the evaluation.
- Identify the actual tasks required to perform the review, considering the techniques, tools and timing.
- Assign employees to tasks and deadlines for task completion.

2

Gather information

- Collect the data through review of relevant documentation, interviews and questionnaires.
- Organise the data.
- Examine collected information.

3

Analyse information

- Brainstorm information with the team.
- Compare information to evaluation criteria.
- Identify root causes of issues through cause and effects analysis.
- Prioritise issues.
- Identify areas where processes are effective and consider using this information to improve areas with issues or that could be improved.

4

Develop recommendations and plan improvements

- Determine what can be done to improve each process through brainstorming with the evaluation team.
- Develop recommendations.
- Identify tasks to implement improvements and the resources required.
- Prepare an action plan for improvement.
- Assign responsibilities to tasks required to implement improvements, which may require the development of new policies and procedures to maximise efficiency and accuracy, the purchase of new software add-ons to improve reporting etc.
- Seek approval from relevant senior management.

5

Implement and monitor improvements

- Implement the approved action plan.
- Ensure relevant staff are aware of changes and any training required in new procedures is organised and actioned.
- Monitor performance according to identified time lines.
- Assess the effectiveness of improvements.

Identify analysis considerations

Financial analysis is arguably the most important part of the evaluation process. You should be able to figure out what the financial problem or issue is, what solutions might work to combat part of or all of that problem, and take stakeholders into account.

The following questions need to be considered when evaluating any financial management process.

Planning

- Are the appropriate systems (accounting processes) in place to plan for financial management?
- Does the organisation follow generally accepted accounting principles?
- Are the right financial areas being analysed?
- Are the appropriate analysis techniques being implemented to identify historical and current financial positions?
- Does the financial software being used meet organisational planning requirements? Can software features be developed or redeveloped to improve the process?
- Are those involved in the financial planning process ensuring that financial management objectives align with organisational financial objectives?

Budgeting

- Do the information collection procedures enable effective and efficient budgeting?
- Are the current timing requirements appropriate to ensure effective decision-making for an organisation's planning cycle?
- Are financial processes transparent and do they meet accountability requirements?

Control

- Do the information collection procedures enable effective and efficient control of finances?
- Are the right employees and techniques involved in monitoring actual performance against budgeted performance being accessed?
- Are effective risk and fraud policies and procedures in place?
- Is the risk management process effective?
- Is there an auditable trail of transactions?
- Does the software meet control requirements? Can the software be developed or redeveloped to improve the financial process?
- Are regular internal and external audits being performed to improve processes and practices?

Reporting

- Are the appropriate financial statements prepared and regularly analysed to ensure effective decision-making?
- Do the information collection procedures enable effective and efficient reporting?
- Does the software meet reporting requirements for senior management, owner, shareholder and staff decision-making?
- Is the software compliant with statutory and legislative reporting requirements?
- Are reports consistently prepared on time and according to organisational financial reporting requirements?

Example: reviews, evaluations and audits

The main objective behind undertaking review, evaluation and audit processes is to promote greater accountability and transparency within an organisation's financial operations. If undertaken correctly, these financial tools provide managers with a professional financial second opinion on current financial planning and managing operations, and thus support them to enhance organisational financial results.

Review the following websites for examples of how different organisations approach reviews, evaluations and/or comprehensive audits of financial management processes:

- Myer Holdings Limited, 'Audit, Finance and Risk Committee Charter', available at: <http://aspirelr.link/myer-investor-media-centre>.
- Panoramic Resources Limited, 'Audit Committee Charter', available at: <http://aspirelr.link/panoramic-resources-audit-committee-charter>.
- Queensland Government, Queensland Treasury and Trade, Financial Accountability Handbook, 'Financial reporting requirements', available at: <http://aspirelr.link/financial-reporting-requirements>.

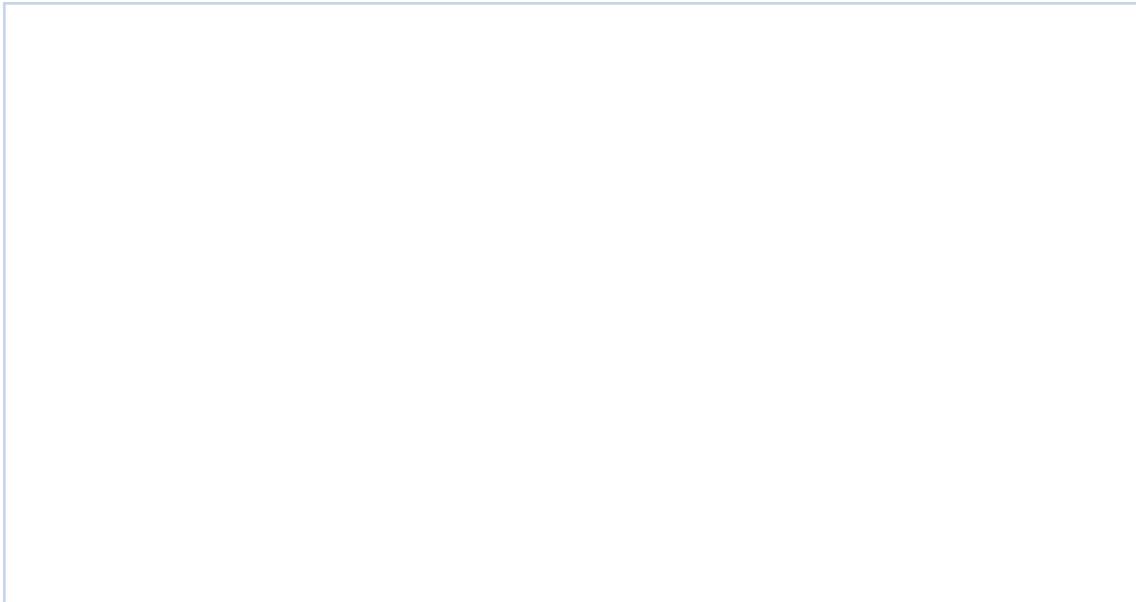


The following are guidelines for evaluating and improving financial practices:

- International Federation of Accountants, 'Evaluating and Improving Internal Control in Organizations', available at: <http://aspirelr.link/ifac-report>.

Practice task 14

Explain the importance of reviewing and improving internal financial controls.



Summary

1. Financial reports and recommendations must be accurate to effectively and successfully guide an organisation's financial operations. They must comply with organisational policies and procedures, which are often guided by statutory and legislative regulations in terms of content and format.
2. In providing financial business recommendations, managers first need to analyse significant issues from the analysis of the financial statements.
3. Techniques for identifying significant issues within financial statements include budgetary variance analysis and horizontal analysis.
4. Ratio analysis helps managers make recommendations to senior management based on the performance of an organisation's financial standing.
5. Recommendations should be considered in light of internally implemented control measures and prepared contingency plans.
6. New or better financial management processes need to be developed to ensure an organisation continues to achieve its financial objectives, and to meet statutory and legislative requirements.
7. The evaluation of processes involves a review of existing practices and controls, and the planning and monitoring of actions to implement improvements.

Learning checkpoint 4 Report on finances

This learning checkpoint allows you to review your skills and knowledge in reporting on finances.

Part A

1. How do statutory requirements affect the content and structure of organisational financial reports?

2. Which agencies have developed Standard Business Reporting (SBR) enabled reporting?

3. What risk management tool can be used to prioritise significant issues in statements?

4. What must the recommendations be ultimately aimed at?

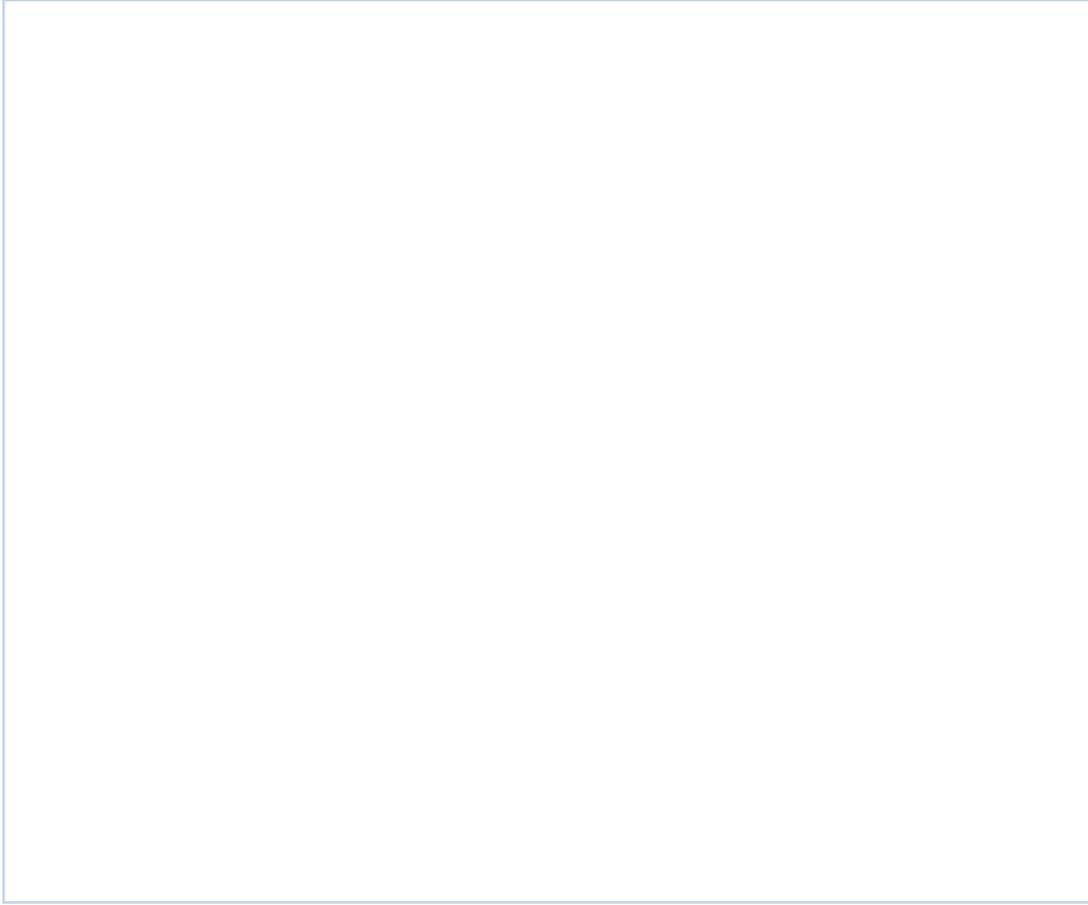
5. Explain the relationship between internal controls and organisational objectives.

6. What analyses may be used to provide information for tender or proposal bid estimates?

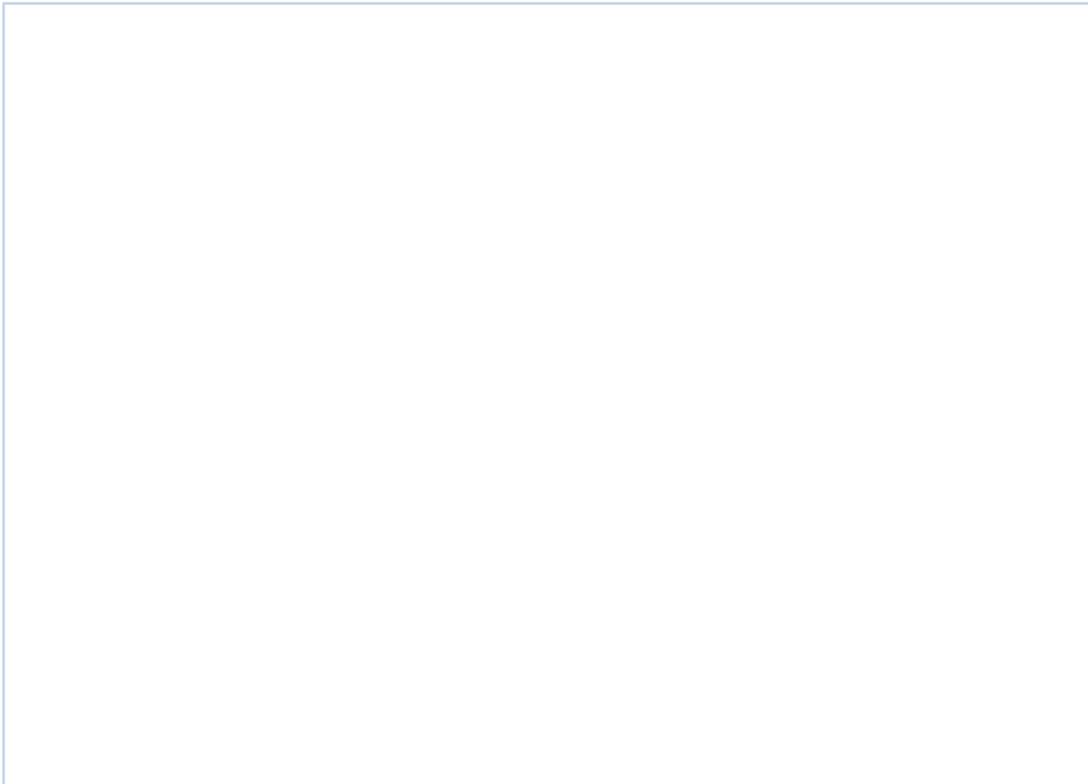
Part B

In this section you are required to consider the reporting of financial statements and methods for conducting an audit of financial management processes for your organisation, or one that you are familiar with. This may be an organisation that you have previously worked for or one that you are in close contact with, such as your training provider, a not-for-profit organisation that you volunteer for, or a sporting or social club.

1. Outline the report presentation requirements (content and structure) for a monthly financial report. Ensure you identify how recommendations to improve positions are presented, whether independently or within the monthly report.



2. Document the tools and techniques used to identify significant issues in statements, and for prioritising issues for responses.



A large, empty rectangular box with a thin blue border, intended for the student to provide an answer to the question above.

3. Develop a checklist for an internal audit of the organisational internal control.

A very large, empty rectangular box with a thin blue border, intended for the student to develop a checklist for an internal audit of the organisational internal control.