

BSB 7.0

BSBFIN601

MANAGE ORGANISATIONAL FINANCES

BSBFIN601

Manage organisational finances

Release 1

Learner Guide

Aspire Version 1.1



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Before you begin

This Learner Guide is based on the unit of competency *BSBFIN601 Manage organisational 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	These highlight key 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.
Summaries	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 provides definitions for each foundation skill.

Foundation skill area	Foundation skill description
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
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
Reading	<ul style="list-style-type: none"> Analyses and evaluates complex organisational information and legislative requirements 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
Teamwork	<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
Initiative and enterprise	<ul style="list-style-type: none"> Identifies and complies with legislative and organisational requirements in undertaking own work
Planning and organising	<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
Technology	<ul style="list-style-type: none"> 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: Prepare for financial management	1A Assess financial performance	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	1B Analyse critical dates and business initiatives	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	1C 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 Develop and circulate budgets	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	2B Implement controls to minimise risk of improper financial behaviour	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	2C Determine budget variances	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
Topic 3: Report on finances	3A Meet financial reporting requirements	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	3B Prioritise significant issues and prepare financial recommendations	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	3C Evaluate financial management processes	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident



Topic 1 | Prepare for financial management

- 1A Assess financial performance
- 1B Analyse critical dates and business initiatives
- 1C Review statutory requirements and taxation liabilities

1A Assess financial performance

Past financial performance is often the best indicator of an organisation's overall worth and useful for predicting future financial trends.

A key requirement when preparing for financial management is to collect and assess historical financial data. An organisation's success will be dependent on its ability to use this data to aid future decision-making and drive the business further.

Before looking at financial performance indicators and how these can be used effectively by organisations, let's review several accounting and financial management principles.

Financial management and accounting

The purpose of financial management is to ensure funds are available for the activities an organisation needs to perform to meet business objectives. This includes paying 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.

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.

Internal users, such as managers and directors, need information for organisational decision-making. This form of accounting is known as management accounting.

External users, such as government departments, need 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 decide whether to lend money for investment. This is typically referred to as financial accounting.

Key accounting terms

Financial management has its own language. It is important that you understand key accounting terms used regularly when preparing and reporting on financial data and systems.

The following terms are 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 in 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, stock, accounts receivable (AR), 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 in 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 in the current accounting period (usually 12 months)
- non-current liabilities – liabilities due for settlement beyond the current accounting period.

Owner's equity (OE)

OE 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.

OE 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 OE decreases.

Revenue

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
- 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.

Accounting principles

The framework for preparing financial statements, known as the generally accepted accounting principles, 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 in 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.

Australian Accounting Standards

Australian Accounting Standards set out the financial reporting standards, including procedures, practices and disclosure requirements, that apply to all sectors of the Australian economy.

Australian Accounting Standards are 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 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: aspirer.link/aasb-standards

Identify reasons for business profit or loss

To identify which areas of the organisation are generating a profit or loss and to assess the reasons for change, managers can analyse the profit and loss (P&L) statement and the balance sheet.

The 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.

P&L statement

The P&L statement essentially reports on the earning activities of the business whereby:
 Net profit (Loss) = Revenue – 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.

Example

P&L 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 2020	
<i>Revenue</i>	
Sales	55,250
Interest earned on investments	7,000
TOTAL REVENUE	62,250
<i>Expenses</i>	
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 P&L statement

Once profit margins have been determined, managers can compare them with previous periods – year to date – 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 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 gross profit margin 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. The formula used to calculate this is as follows:

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

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 remain. 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	Cost of goods sold (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%

To work out the net profit, the net profit ratio will need to be calculated as follows:

- Net profit after tax = $\$60,000 \times (1 - 0.35) = \$39,000$
- Net profit ratio = $(\$39,000 / \$100,000) \times 100 = 39\%$ 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.

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 OE.

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 (OE) 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. In the asset and liability sections of the balance sheet, items are listed in terms of their liquidity.

Example

Balance sheet

The AtoZ Business balance sheet below gives information on the company's financial standing as at 30 June 2020. This balance sheet shows what AtoZ 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.

AtoZ Business Pty Ltd			
Balance sheet as at 30 June 2020			
ASSETS	\$	LIABILITIES	\$
<i>Current</i>		<i>Current</i>	
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	<i>Non-current</i>	
<i>Non-current</i>		Loan	8,000
Motor vehicles	20,000	Mortgage	105,000
Machinery	2,000		113,000
Production equipment	10,000		
Land	55,000	TOTAL LIABILITIES	131,250
Buildings	35,000	OWNER'S EQUITY	
	122,000	Capital	17,250
TOTAL ASSETS	148,500		148,500

Calculate OE

In addition to relating profits or losses to sales, it is also useful to express them in terms of total OE, as this gives a measurement of the return being generated on the funds being invested in the business by the owners or shareholders.

The return on OE 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 OE.

Calculating the owner's return from business

Return on OE ratio = (Net profit / Average OE) x 100

Calculating average OE

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

Average OE = (OE at beginning of period + OE at end of period) / 2

Example

Return on OE ratio

Pantonellic Enterprises shows a net profit of \$23,000 for the year ended 30 June 2019 and \$25,000 for the year ended 30 June 2020. The OE section of the balance sheet shows the following balances.

Year ended 30 June	Balance (\$)
2018	190,000
2019	200,000
2020	237,000
Calculation of the return on OE for 2018–19: (23,000 / 195,000) x 100 = 11.79%	Calculation of the return on OE for 2019–20: (25,000 / 218,500) x 100 = 11.44%

In this example, the return on OE ratio has decreased, indicating that the owner's return from Pantonellic Enterprises has diminished. In 2018–19, each dollar of owner's funds invested yielded 11.79 per cent in net profit; this dropped to 11.44 per cent in 2019–20.

Although profits increased from \$23,000 to \$25,000 (an 8.7 per cent rise), the average OE 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 2019–20 as in 2018–19. 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 return on assets (ROA) ratio 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 tax / Average of total assets) x 100

Taxation and interest expenses

└ When calculating the ROA, the organisation's tax 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 comprise 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

Example: Return on total assets ratio

For Pantanellic Enterprises, net profits for 2018–19 and 2019–20 were \$23,000 and \$25,000 respectively.

Year ended 30 June	Current assets	Non-current assets	Balance
2018	150,000	210,000	360,000
2019	145,000	225,000	370,000
2020	165,000	300,000	465,000

The tax and interest expenses for the business were:

Year ended 30 June	Tax expense	Interest expense
2019	9,200	2,500
2020	9,700	3,300

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

2018–19	2019–20
$(34,700 / 365,000) \times 100$ = 9.51%	$(38,000 / 417,500) \times 100$ = 9.10%

This example shows that Pantanellic used its asset base less effectively in 2019–20 (9.10 per cent return) than in 2018–19 (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 2019–20 compared with only \$365,000 in 2018–19). 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 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.

Calculate cashflow ratios

Managing cashflow involves identifying money coming into the business and balancing it against money going out.

The aim is to ensure that demands for cash are not made before money due to be collected has been received. The effect on an organisation with poorly managed cashflow can be catastrophic.

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:

$$\text{Cashflow solvency} = \text{Cashflow from operating activities} / \text{Total liabilities}$$

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:

$$\text{Cashflow margin} = \text{Cashflow from operating activities} / \text{Sales}$$

Cashflow ROA

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

$$\text{Cashflow ROA} = \text{Cashflow from operating activities} / \text{Total assets}$$

Ageing summaries

The AR (debtors) ageing summary is a listing, or report, of all the amounts owing to the organisation from its customers, including the total amount owed by each.

The schedule helps management establish which customers are most overdue on their payments and which customers have the largest amounts outstanding. The organisation can therefore focus its resources and time on collecting payments from these customers first.

When an organisation's money is tied up in accounts receivables, there is a flow-on effect to other business operations such as marketing, funding for expansion, investments or the opportunity to take advantage of supplier promotions and discounts.

Example

Aged debtors summary

Aged Debtors Summary as at 30 June 20XX					
Debtor	Total AR	1-30 days	31-60 days	61 -90 days	over 90 days
P. Steinway	\$				
D. Sparks	\$ 654.50			\$ 654.50	
M. Brown	\$				
P. Daley	\$ 1,105.50				\$ 1,105.50
M. Lark	\$ 855.00	\$ 605.00	\$ 250.00		
L. Rogers	\$ 1,708.00	\$ 1,708.00			
	\$ 3,693.00	\$ 1,683.00	\$ 250.00	\$ 654.50	\$ 1,105.50

The above aged debtors summary is useful in helping management with the following:

- identifying which invoices are overdue for payment and by how much
- estimating the amount of potential bad debts so that adjustments can be made in the general ledger
- determining the effectiveness of the credit and collections functions.

Turnover of accounts receivable

The rate of turnover of AR measures the relationship between net credit sales and AR, where net credit sales equals the total credit sales less any credit sales returns.

The rate of turnover of AR gives an indication of the time taken to collect an organisation's AR debt.

Turnover periods that are longer than the credit period offered to debtors could indicate an issue with credit management policies and systems. Management should investigate to determine the root causes and update or enforce existing policies to help improve the rate of turnover.

The rate of turnover of AR is expressed as follows.

Rate of turnover of AR

AR turnover = Net credit sales / Average AR

Calculating average AR

Average AR is calculated by taking the opening AR figure from the balance sheet for the period under review, adding it to the closing AR figure on the balance sheet for the same period, then dividing by two.

Average AR = (AR at beginning of period + AR at end of period) / 2

Example

Calculating rate of turnover of AR

If Beyond Borders Pty Ltd.'s net credit sales for the year came to \$210,000 and the average AR was calculated to be \$35,000, the rate of turnover of AR would be calculated as follows:

AR turnover = \$210,000 / \$35,000

= 6 times per year, or 60.83 days

If Beyond Borders's credit term was 60 days, this turnover rate would be considered acceptable; however, as its credit policy states credit terms are 30 days, the above turnover rate is very poor.

Conduct cost-volume-profit analysis

Cost-volume-profit (CVP) analysis is a technique used to identify an 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 with 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

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 an 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 P&L. 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 involves the analysis of how each item in the financial statements has changed from this period to last, and is an alternative to ratio analysis.

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' 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 2019 and 2020					
Horizontal analysis					
	March 2020	March 2019	Dollar amount	Per cent	
Sales	1,245,000	1,050,000	195,000	18.6	F
Less COGS	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

F = Favourable U = Unfavourable

Horizontal analysis continued...

Carapel Industries					
Comparative income statement for the month of March 2019 and 2020					
Horizontal analysis					
	March 2020	March 2019	Dollar amount	Per cent	
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

Several issues need further examination:

- What factors led to sales increasing by nearly 20 per cent? This is a significant increase.
- The report shows 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

Financial data can be compared with data from other sources to provide a more meaningful picture on which to base financial management decisions.

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 and averages. The following table shows a number of potential reasons for variations, along with reports that can be used as sources of information.

Reasons for variations
<ul style="list-style-type: none"> ▪ 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
<ul style="list-style-type: none"> ▪ COGS 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

Electronic accounting systems

Electronic accounting 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 preparation are the income (P&L) 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

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.

Suitability of financial management software

- 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 P&L 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 in 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?

Practice Task 1

Question 1

Which of the following statements about accounting principles, practices and calculations are correct? Tick all that apply.

- Accrual accounting requires that income earned and expenses incurred in one period (usually 12 months) be recognised in that period.
- The P&L statement represents the organisation's financial position based on what it owns and owes.
- The cashflow margin measures how an organisation converts sales to cash.
- Australian Accounting Standards set out the financial reporting standards, including procedures, practices and disclosure requirements, that apply to the Australian economy's private sector only.
- Once profit margins have been determined, managers can compare them with previous periods to identify the impact of issues such as increasing costs or low selling prices.

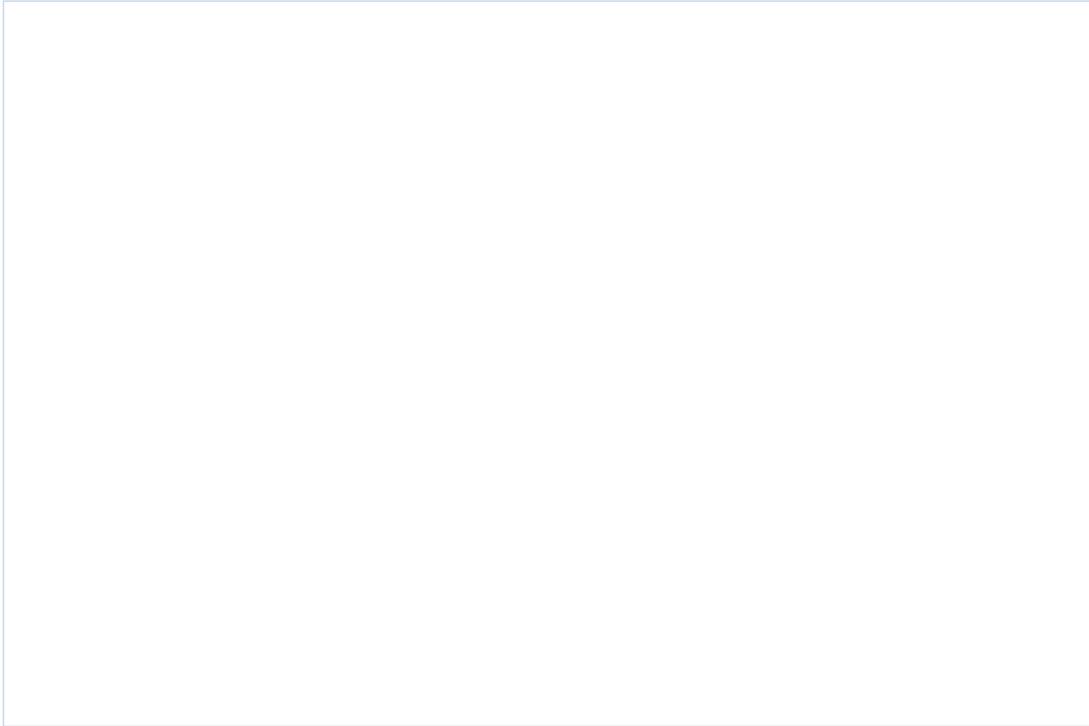
Question 2

When reviewing the suitability of accounting software, what should be considered? Tick all that apply.

- Is the system able to produce sales, purchases and inventory reports?
- Is the system ATO compliant, allowing the organisation to process and electronically lodge tax payments?
- Does the system enable managers to produce comprehensive business plans?
- Does the system enable managers to analyse data and produce variance reports?
- Can the system back up data without being prompted?

Question 3

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



1B Analyse critical dates and business initiatives

Managers need to familiarise themselves with their business plan for the next financial cycle to determine what resources are needed to undertake activities to meet organisational objectives, and when exactly they will be required.

Strategic, business or operational plans, which incorporate new initiatives, 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 needed 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 regularly, with the information from the analysis used to inform decision-making.

The types of business plans that need be identified and reviewed for implementing initiatives will depend on the size and nature of the organisation. Following is a description of the types of plans and the budgets prepared to support them.

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 help managers analyse cashflow trends to determine an organisation's ability to implement a budgetary strategy.
- Operational plans generally include budgets, such as the 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.

Cashflow 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 2

Question 1

Why is it important for managers to review their business plan when preparing for financial management?

Question 2

What types of information should managers obtain from their business plan when preparing for financial management? Tick all that apply.

- New business initiatives
- Executive summary
- Action plans
- Budgets
- Competitor analysis

Question 3

Which of the following statements about cashflow are correct? Tick all that apply.

- Cashflow represents the money available to the organisation once all other operating activities have been considered.
- It is important to consider the cost of implementing new initiatives so that arrangements for borrowing extra funds can be put in place.
- Operating activities are concerned with cash payments to acquire assets and the cash received for the disposal of assets.
- Cashflow trends can be identified by plotting key ratios on a graph.
- Financing activities relate to the financing of the business; for example, a loan to the business and payments to the lender to repay the loan.

1C 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 compliance, the organisation needs to understand what these requirements and liabilities are, and know which regulatory bodies the financial reports and payments must be submitted to, the formats in which to give the information, and the timelines and constraints.

Some of the regulatory requirements are:

- report goods and services tax (GST) and other taxation-related issues relating to the business activity statement
- administer and report on the superannuation guarantee levy
- comply with the capital gains tax and fringe benefits tax regulations
- comply with the *Income Tax Assessment Act 1997* (Cth)
- comply with the Corporations Law including the *Corporations Act 2001* (Cth)
- comply with the Australian Accounting Standards
- comply with relevant state/territory taxation requirements such as payroll tax and superannuation payments.

Key regulatory bodies

Regulatory authorities are responsible for exercising autonomous authority over some area of financial activity in a regulatory or supervisory capacity.

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

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 income tax to the ATO quarterly using a business activity statement and prepare an income tax return at the end of each year in line with the requirements of the Income Tax Assessment Act.

Read more about the requirements for businesses on the ATO's website: aspiirelr.link/ato-business

ASIC

ASIC is the chief regulatory agency of all incorporated entities (public and private) and fund managers in Australia. It 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: aspirerlr.link/lodging-financial-reports

Australian Securities Exchange (ASX)

Australian companies listed on the securities 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 extra 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: aspirerlr.link/asx-rules-guidance-notes

Australian Prudential Regulation Authority (APRA)

APRA is the federal government agency responsible for regulating Australia's banks; building societies; friendly societies; credit unions; private health, life and general insurers; reinsurance companies; and many superannuation funds. Its purpose is to ensure that these financial services operate prudently; that is, that they maintain safety and soundness so that the interests of depositors, policyholders and superannuation fund members are protected.

If a 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. There are different frameworks for authorised deposit-taking institutions (e.g. banks, credit unions), general insurers, superannuation organisations, life insurance and friendly societies, and non-regulated entities.

To learn about the reporting frameworks for different institutions, visit APRA's website: aspirelr.link/apra

Review taxation liabilities

Managers need to be aware of specific forms of taxation, such as GST liability and payroll tax, which must be calculated and provided for regularly.

The calculation and submission of taxation liability is an important part of an organisation meeting its statutory reporting requirements.

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

GST

- Most organisations with an annual turnover of \$75,000 or more are required to register for the GST.
- Not-for-profit organisations must register for GST if their annual turnover is \$150,000 or more.
- 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 must complete a monthly payroll tax return and submit it to the state/territory 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 (FBT)

- Organisations that provide employees with payments in the form of non-cash benefits may have to register for and remit 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 (PAYG)

- 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 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/time earnings).
- 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.

Practice Task 3

Question 1

What is the relationship between the AASB and the IASB?

Question 2

Which of the following are examples of statutory requirements in financial management?
Tick all that apply.

- Ensuring the health and safety of finance co-workers
- Lodgement and payment of GST
- Compliance with the Corporations Law, including the Corporations Act
- Ensuring the basic human rights of clients
- Compliance with the Australian Accounting Standards

Question 3

Which of the following statements about taxation liabilities are correct? Tick all that apply.

- Most organisations with an annual turnover of \$25,000 or more are required to register for the GST.
- Payroll tax is a state/territory tax imposed on organisations with a total Australian payroll that exceeds the annual payroll tax threshold of \$600,000.
- 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).
- Throughout the financial year, an organisation must forward payments to the ATO in accordance with the PAYG system.
- FBT is paid by employers on certain benefits they provide to their employees or their employees' family or other associates.

Summary

- 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.
- To effectively manage finances, all managers need knowledge of the accounting process, accounting principles, accounting standards and accounting software systems.
- Analyses of historical P&L statements, the balance sheet, cashflows and ageing summaries enable managers to identify which areas of an organisation are performing well, which areas are not performing well and the reasons why.
- The financial position of the organisation is the economic condition and financial stability of the business, its financial structure and its level of solvency.
- 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.
- 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.
- Australian organisations have statutory requirements affecting the manner and frequency of their financial reporting and may have Commonwealth and state/territory taxation liabilities.

Learning Checkpoint 1

Prepare for financial management

Part A

1. Draw a line to match the beginning of each sentence about financial reporting requirements to the correct ending.

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

» register for the GST.

» Most organisations with an annual turnover of \$75,000 or more are required to

» meet the requirements of the PAYG system.

» FBT is paid by employers on certain benefits they provide to

» meet the requirements of the Superannuation Guarantee Scheme.

» Throughout the financial year, an organisation must forward payments to the ATO to

» all sectors of the Australian economy.

» Australian Accounting Standards set out the financial reporting standards, including procedures, practices and disclosure requirements, that apply to

» their employees or their employees' family or other associates.

2. Which of the following calculations, ratios and indicators will be useful in identifying reasons for past profits and/or losses in business trading activities? Tick all that apply.

- Net profit margin
- Employee satisfaction rating
- Cashflow margin
- Gross profit margin
- Keywords in top 10 search engine results

3. List five factors to consider when reviewing the suitability of accounting software.



Part B

Read the case study, then answer the questions that follow.

Case study

Derek is the finance manager for an industrial fasteners company in eastern Victoria.

As the second half of the financial year draws to a close, Derek and his finance team begin the lengthy process of developing the budgets for the upcoming new financial year.

Before preparing the new budgets, Derek must first analyse existing data to help him establish areas of the business that are contributing to profits and areas that are generating losses. Derek uses a range of financial analysis techniques such as ratios, budgetary analysis and horizontal analysis to establish current performance levels and help guide him in producing sound financial and business decisions.

He must also consult the company's business plan to familiarise himself with the direction the company wishes to take in the new financial year and establish any critical dates in cashflow trends.

Lately, Derek has been researching other accounting software products. He is carefully considering migrating the company's financial data to cloud-based accounting software on 1 July. The company's existing software is not cloud-based, and Derek particularly likes the added functionality that this new type of software will provide.

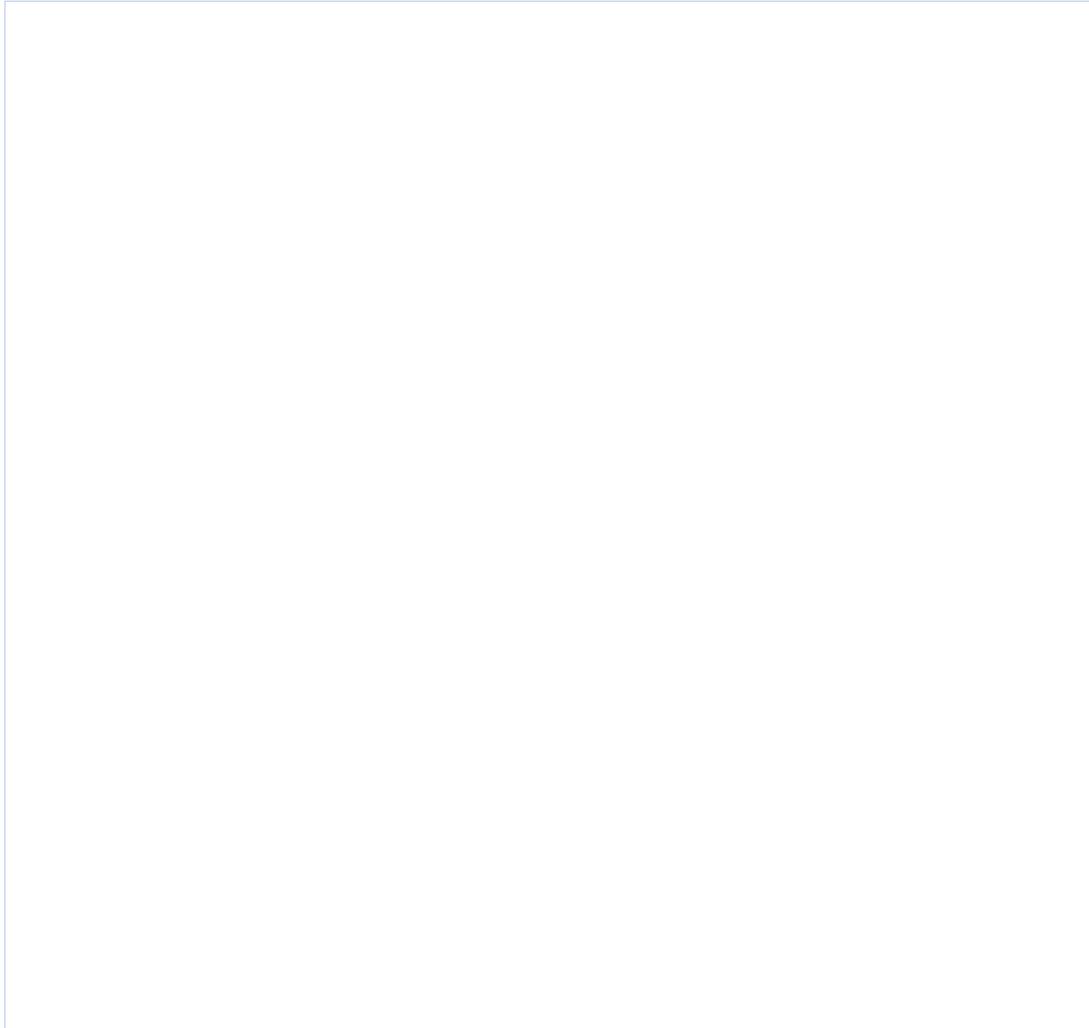
1. What is horizontal analysis and how would it assist Derek in preparing the budgets for the new financial year?

2. Derek is comparing the profitability of three individual products: bolt A, bolt B and bolt C. Which of the following results are correct? Tick all that apply. (Round all answers to the nearest whole amount.)

Product	COGS/ unit	Fixed costs/ unit	Selling price/ unit	Gross profit/ unit	Units sold	Revenue	Gross profit margin	Net profit margin
Bolt A	\$15.00	\$10.00	\$55.00	\$_____	500	\$_____	_____%	_____%
Bolt B	\$13.00	\$10.00	\$45.00	\$_____	669	\$_____	_____%	_____%
Bolt C	\$14.00	\$10.00	\$48.00	\$_____	420	\$_____	_____%	_____%

- Gross profit margin of bolt A is 73 per cent
- Net profit margin of bolt C is 71 per cent
- Gross profit margin of bolt C is 71 per cent
- Net profit margin of bolt B is 49 per cent
- Gross profit margin of bolt B is 49 per cent

3. List four types of information Derek should be gathering from the company's business plan when preparing for financial management.





Topic 2 | Establish budgets and allocate funds

- 2A Develop and circulate budgets
- 2B Implement controls to minimise risk of improper financial behaviour
- 2C Determine budget variances

2A Develop and circulate budgets

An organisational budgeting process involves the preparation of budgets for all areas of activity in 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 (P&L) 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 needed 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 in a fast-moving industry such as information technology may set rolling monthly budgets.

Allocation of resources and budgeting

Resource allocation refers to the dissemination of resources, and in particular finance, to each department or cost centre. Budgeting denotes the more detailed determination of how these resources are to be used.

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 its 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 P&L 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.

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 regular analysis of its financial health.

The budget also aims to ensure an organisation will have the working capital needed to meet activity costs. This process relies on effective cashflow forecasts.

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 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 considered, as these would affect (at the very least) loan payments. This is discussed in greater detail later in this topic.

The federal government and state governments have developed a number of cashflow forecast templates by to help people who need to prepare a forecast for their organisation but do not have existing tools. Some helpful websites are:

- Government of Western Australia, Small Business Development Corporation: aspirelr.link/business-tools-and-templates
- State Government Victoria, Business Victoria, 'Cash flow forecasting': aspirelr.link/business-vic-cashflow
- Tasmanian Government, Business Tasmania, 'Preparing a cash flow forecast': 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 sales budget is used for making decisions related to purchasing, production and cashflow.

The forecast 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.

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 Systems, 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, visit: aspirelr.link/abs-time-series
- Causal forecasting, which uses regression to determine cause and affect behaviour. For example, low interest rates affect demand for products in a market and increase the disposable income of purchasers. The Khan Academy has information relating to regression analysis at: aspirelr.link/khan-quant-data

A number of sales forecast templates developed by governments are available to help people who need to prepare a sales forecast for their organisation but do not have existing tools. These include:

- Government of Western Australia, Small Business Development Corporation, 'Budgets and forecasts': aspirelr.link/wa-business-forecasts
- Queensland Government, business and industry portal, 'Sales forecasts and targets': aspirelr.link/qld-business-forecasts

Analyse the expenses budgets

An expenditure budget is the portion of an organisation's master budget that records the costs needed to operate the business. 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 needed 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 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 in 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.

Develop the budgeted P&L

A budgeted P&L summarises expected income and expenses. It is a plan to guide an organisation's operational spending within a specified period.

Managers often prepare the P&L 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.

The following table outlines the process for setting the P&L budget.

P&L 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 needed to meet organisational objectives, which should be quantified.

Example

P&L budget

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

Profit and loss report for the year to 29 February 2020							
	Month to date		Year to date (YTD)			YTD	
	Actual	Budget	Actual	Budget	Variance	Last Year	2019/20 Budget
	(\$ '000)	(\$ '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

P&L budget continued...

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

A budgeted balance sheet projects the balances of assets and liabilities and 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. For example, if the budgeted balance sheet reveals a weakness in cashflow, an organisation might revise its capital expenditure plan.

The budgeted balance sheet comprises all of the line items recorded in a standard balance sheet, except that it is a projection of what the balance sheet will show during future budget periods.

The process for setting the budgeted 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 (OE) 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 P&L budget, the balance sheet budget is usually presented in the format of the balance sheet for later analysis.

Budgeted balance sheet as at 29 February 2020				
	2018/19 Actual at 30 June 2019	2019/20 YTD Actual	2019/20 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

Circulate budgets

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 in 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.

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 needed 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.

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 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. Team members' responses and concerns need to be raised and addressed promptly and properly.

Managers and supervisors have various information needs when given the responsibility of managing organisational finances.

Without the correct information, managers could miss statutory reporting requirements or not be able to track resource allocation, and individual departments might start moving away from the overall goals of the business.

Information that managers need includes:

- finalised and approved budgets for their area
- organisational policies, procedures and guidelines for allocating funds to tasks and monitoring spending against proposed budgetary requirements
- information on who to give the relevant data to and when, to ensure the organisation meets its Australian Taxation Office (ATO), Australian Securities and Investments Commission (ASIC), (Australian Securities Exchange (ASX), Australian Prudential Regulation Authority (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, 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 in 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 so all staff are aware of the organisation's budget position and broad plans for the forthcoming financial year.

Practice Task 4

Question 1

What three budgets/budgeted statements should be included in an organisation's master budget?

Question 2

Which of the following statements about budget preparation are correct? Tick all that apply.

- Using the top-down budget approach, budget input is coordinated by lower levels such as team leaders.
- Incremental budgeting would be most appropriate for organisations that have developed new strategies and/or those that operate in dynamic industries.
- A budgeted balance sheet will contain details of long- and short-term assets, long- and short-term liabilities as well as OE.
- The sales budget is used for making decisions related to capital expenditure.
- Time series and causal forecasting are examples of qualitative forecasting methods.

Question 3

Why it is essential to communicate key elements of budgets to management and confirm their understanding?

2B Implement controls to minimise risk of improper financial behaviour

Internal controls give reasonable assurance about the achievement of operational objectives. This includes reliable and accurate financial reports, the effectiveness and efficiency of operations, and compliance with applicable laws.

Effective financial 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.

Misappropriation of funds

Misappropriation of funds refers to an employee or director abusing their position in an organisation to steal funds belonging to the organisation through fraudulent workplace activity.

The misappropriation of funds falls under the category of fraud and is illegal under various Commonwealth, state and territory crimes Acts. The information below shows some examples of misappropriation and describes 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:
- *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth), commonly called CLERP 9
 - the Australian Government Auditing and Assurance Standards Board's Auditing Standard ASA 240: The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report, relating to transparency in accounting and reporting; and accountability, by making board members and executives personally responsible for financial reports.

Managers need to identify the likelihood of funds misappropriation and discrepancies, the impact of these risks and current controls in place to address these risks.

Their focus should be on identifying areas of high risk and controls that need to be put in place 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
- 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 control measures

Organisations must have a strong set of measures to ensure the handling, checking and authorisation of financial information is done correctly.

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 done
- implementing a code of ethics to promote appropriate behaviour.

A financial risk management policy provides the framework to manage risks associated with an organisation's operational activities. The policies will depend on the organisation and its financial reporting systems and requirements.

The following policies may be implemented to set up a control framework for financial control, including fraud.

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.

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.

It 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 (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.

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.

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 taxpayers to the ATO under the *Tax Laws Amendment (Implementation of the FATCA Agreement) Act 2014* (Cth) to combat offshore tax evasion.

Practice Task 5

Question 1

What approaches should be taken to comply with financial due diligence? Tick all that apply

- 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
- Review of employee recruitment policy
- Implementation of new innovative technology

Question 2

Which of the following statements about financial risk management are correct?

Tick all that apply.

- An audit trail is a trail used to track the detailed transactions relating to any line item in an accounting record.
- The segregation of duties is useful for ensuring all transactions are recorded.
- Director due diligence obligations, duties, responsibilities and reporting requirements fall under the *Income Tax Assessment Act 1997* (Cth).
- A financial management risk policy should be in place to stipulate requirements for the appropriate recording of transactions and maintaining an audit trail.
- Organisational accounting systems should include options to delete or remove incorrect accounting entries from permanent record.

Question 3

List four ways misappropriation of funds might occur.



2C Determine budget variances

Monitoring financial projections against actual results regularly helps to ensure financial control, identify where adjustments are needed, and establish where contingencies should be implemented to manage issues.

Review P&L reports

A review of an organisation's P&L report can help identify variances and supports managers to determine any issues in meeting the organisation's objectives.

Variances exist for many reasons and it is a manager's responsibility to investigate these, using audit trails where necessary. An audit trail is the documented flow of a transaction right through to the financial statements of an entity. Audit trails can also be followed in reverse, to track backwards from a financial statement line item to the originating source document.

Effective accounting systems should have a clear audit trail for all transactions that can be used by internal staff and external auditors to help track down errors and the causes of variances in the financial statements.

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 will not 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?
- Could there be human error involved in entering financial data into the computerised accounting system? Can the transaction/s be traced back through an audit trail to confirm?

Example

P&L 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).

Report on performance for November 2020			
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 percentage. In this way, managers will not spend too much time looking at a \$5 variation in an item listed at \$1,500.

Review cashflow and ageing summaries reports

A careful review of the cashflow and ageing summaries reports will inform management of the organisation's cash position so that contingencies can be put in place if needed.

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 P&L budget, the cash budget variances can be determined by comparing differences between the budgeted cash needed 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 applied and the risk of late-paying customers assessed. Increasingly overdue accounts 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

Statement of cashflows as at 29 February 2020 and forecast to June 2020						
	YTD 2019/20	Actual February 2020	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
Payments 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

Risk controls, 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 needed 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 redesign 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.

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.

Managers may need to consider other appropriate analysis techniques in addition to variance analysis on budgets. If the analyses indicate failure of the control or plan in resolving issues, then management will need to implement further controls. They should reassess risks and develop and implement treatment strategies immediately. For serious issues, the organisation may need to consider getting help from external experts and taking 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. Also, 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 6

Question 1

What measures might you implement to address unfavourable P&L variances as a result of increases in the company tax rate?

Question 2

Which of the following variance analyses are correct? Tick all that apply.

Report on performance for January 2020			
Item	Budget (\$)	Actual	Variance result
Income			
Sales	45,000	47,500	\$ _____
Expenditure			
Direct materials	25,000	22,000	\$ _____
Direct labour	13,450	15,970	\$ _____
Overheads	900	1,200	\$ _____
Subtotal	39,350	39,170	\$ _____
Profit	5,650	8,330	\$ _____

- Direct labour variance was \$2,520 favourable
- Direct labour variance was \$2,250 unfavourable
- Cost of overheads was \$300 favourable
- Sales variance was \$2,500 favourable
- Direct labour variance was \$2,520 unfavourable

Question 3

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



Summary

- The budgeting process involves the preparation of budgets for all areas of activity in an organisation using approaches and methods outlined in an organisation's budgeting policy and procedures.
- 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.
- A P&L 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.
- 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.
- Once budgets are prepared and approved, they should be circulated to relevant managers and supervisors in line with organisational policies and procedures.
- Effective financial controls will ensure that financial recording mechanisms, transactions and statements are accurate and not at risk of exposure to misappropriation of funds and/or discrepancies.
- Misappropriation of funds refers to an employee or director abusing their position in an organisation to steal funds belonging to the organisation through fraudulent workplace activity.
- Organisations must have a strong set of measures to ensure the handling, checking and authorisation of financial information is done correctly. Due diligence refers to the process of validating information related to all areas of the organisation to help manage financial risks.
- Monitoring financial projections against actual results regularly helps to ensure financial control, identify where adjustments are needed, and establish where contingencies should be implemented to manage issues.
- Risk controls, 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.

Learning Checkpoint 2

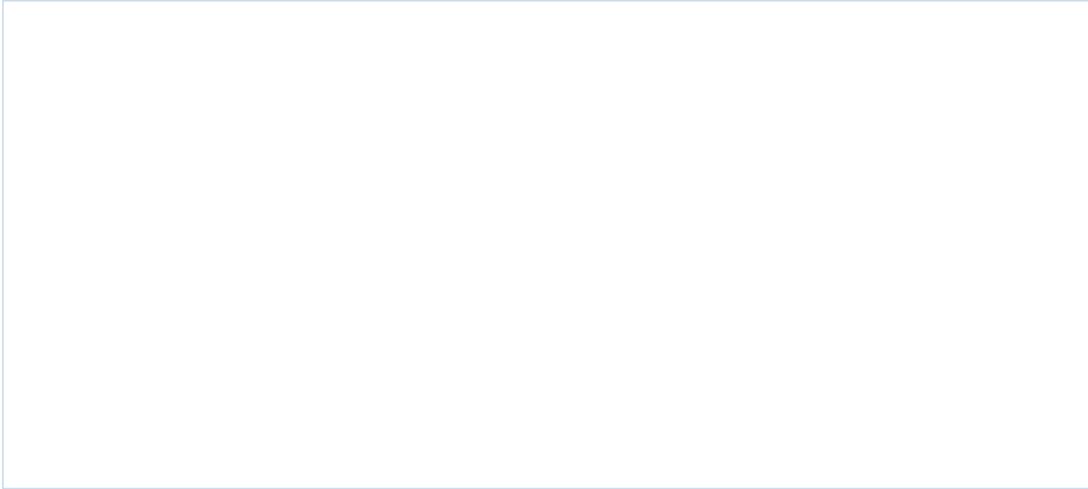
Establish budgets and allocate funds

Part A

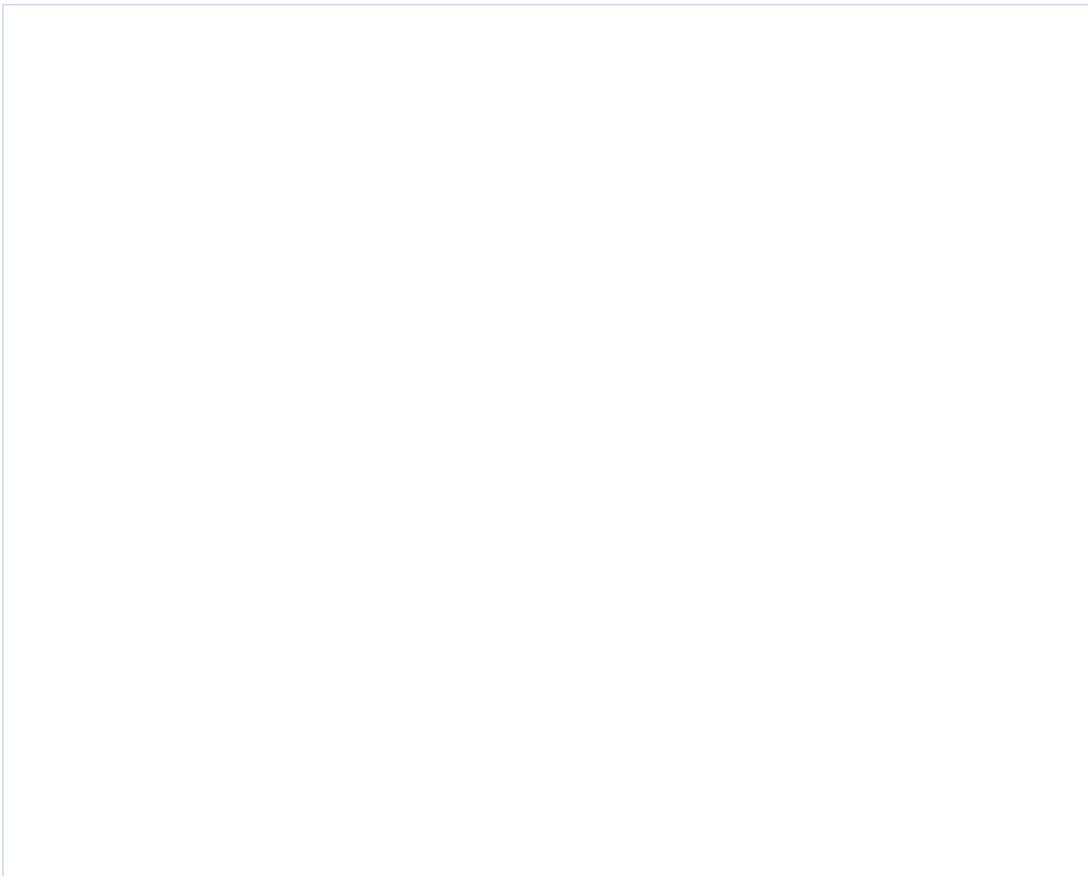
1. Number each step from 1 to 4 in the order you would follow to prepare the budgeted P&L statement.
 - Review the sales forecast to determine the sales revenue, which is the expected units multiplied by their selling price.
 - Calculate the sales targets required to meet organisational objectives, which should be quantified.
 - Review the expenses budget to determine the net profit margins. Add in tax liabilities and interest payments.
 - Review the COGS forecast to determine gross profit margins.

2. Consider the role communication has in regard to circulating budgets to managers. Now answer the following two questions:
 - a) Which of the following methods could you use to circulate budgets to management? Tick all that apply.
 - Face-to-face presentations
 - Group/team meetings
 - Post them on the staff breakout room wall
 - Upload to the organisation's website
 - Video conference
 - Written communication

- b) How would you ensure that managers and supervisors understand budgets, reporting requirements and financial delegations?



3. List six internal control procedures that could minimise the risk of misappropriation of funds.



4. Analyse the following statement of cashflows and answer the two questions that follow.

Statement of cashflows as at 31 July 2019 and forecast to Sep 2019				
	Actual July 2019	Forecast		
		Jul	Aug	Sep
	\$	\$	\$	\$
Receipts	155,000	154,350	136,650	150,230
Total receipts	155,000	154,350	136,650	150,230
Payments to suppliers	50,211	51,150	73,290	55,980
Payment to employees	41,150	40,980	45,930	42,550
Capital purchases	30,750	0	0	0
Total payments	122,111	92,130	119,220	98,530
Cash inc/(dec)	32,889	62,220	17,430	51,700
Cash at the beginning	56,039	56,039	118,259	135,689
Cash held	88,928	118,259	135,689	187,389

- a) What significant event in July caused an unfavourable variance between the budgeted and actual cash held at the end of the month?

- b) Why is it important to revise the cashflow budget in light of this information?

Part B

Read the case study, and then answer the questions that follow.

Case study

Derek is the finance manager for an industrial fasteners company in eastern Victoria. Derek's role involves monthly analysis of financial results, including tracking income and expenditure against budget.

Derek has called a budget committee meeting with departmental managers to discuss the results for the first month of the financial year.

He has supplied each manager with a copy of the following P&L variance report and has asked for their feedback regarding the first month's results. He is considering implementing some contingency plans to help the organisation stay on track to achieve its first quarter targets; however, he would like some input from each department before proceeding.

A recent review of the accounts payable ageing summary also highlighted to Derek that the organisation is consistently late in paying bills. He would like to investigate this further so he can implement appropriate measures to fix it.

Profit and loss variance report for the month of July 2019				
Item	Budget (\$)	Actual (\$)	Variance (\$)	Fav/Unfav/OK
Income				
Area A	45,000	44,832	168	OK
Area B	70,000	59,130	10,870	U
Area C	55,000	60,552	5,552	F
Gross profit	170,000	164,514	5,486	U
Expenditure				
Salaries & on costs expenses	51,000	56,950	5,950	U
Marketing & sales expenses	21,645	21,789	144	OK
Communication expenses	4,502	4,500	2	OK
Governance expenses	2,500	2,500	0	OK
Administration expenses	12,465	16,550	4,085	U
Consumables expenses	18,269	18,354	85	OK
IT, repairs & equip hire expenses	13,550	10,456	3,094	F
Depreciation expense	12,000	12,000	0	OK
Total operating expenses	135,931	143,099	7,168	U
Net profit	34,069	21,415	12,654	U

1. Review the P&L variance report in the case study above and identify which statements are true. Tick all that apply.

- Net profit for July came in 40 per cent under budget.
- Net profit for July came in 37 per cent under budget.
- Net profit for July came in 33 per cent under budget.
- Derek should consider implementing the organisation's contingency plan for Area A's sales targets.
- Derek should consider implementing the organisation's contingency plan for Area B's sales targets.

2. List four ways in which Derek can demonstrate he has complied with financial due diligence.

3. What techniques/skills can Derek use to communicate the key elements of the budgets clearly to managers and supervisors? Tick all that apply.

- Using complicated terminology in its correct context
- Using active listening skills
- Using open-ended questioning to confirm management's understanding
- Considering language needs of those with English as a second language
- Using industry jargon

4. What measures could Derek take after concluding from the payables ageing summary that the organisation is consistently late in paying bills?





Topic 3 | Report on finances

- 3A Meet financial reporting requirements
- 3B Prioritise significant issues and prepare financial recommendations
- 3C Evaluate financial management processes

3A Meet financial reporting requirements

Financial reports must comply with organisational policies and procedures and statutory regulations in content and format.

It is essential that reporting practices are appropriate to the needs of the stakeholders and enable management to make concise decisions to ensure internal and external requirements are being met.

Statutory requirements often provide the basis for an organisation's reports and can be generated through the use of accounting software. Reputable accounting software will include customisable reporting options that enable 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.

Types of accounting reports

Accounting reports can be prepared for internal and external use. Internal (organisational) reports are prepared and presented to different levels of management. Their primary use is to benefit management and aid in decision-making. Reports covering the whole operation of the organisation are referred to as general purpose reports. Examples include profit and loss statement, balance sheet and statement of cashflow. Reports covering sections of an organisation's operations, such as departmental sales reports, are called specific purpose reports.

External and statutory reports are prepared according to guidelines and strict rules enforced by regulatory bodies. They are prepared for external parties such as shareholders, potential investors and government departments.

Organisational financial reporting requirements include:

- Weekly, monthly, quarterly or annual financial statements
- Budgeted variance reports
- Sales reports by time period or department
- Expenditure reports
- Production reports
- Aged payables and aged receivables reports
- Inventory turnover reports
- Payroll reports

Statutory financial reporting requirements include:

- Quarterly or monthly business and instalment activity statements to the Australian Taxation Office (ATO)
- Audited annual financial statements by all entities except small proprietary companies to the Australian Securities and Investments Commission (ASIC)
- Half-yearly financial statements for disclosing entities to ASIC
- Annual and other reporting for listed companies in line with the Australian Securities Exchange (ASX) listing rules
- Payroll and superannuation reporting for small business with fewer than 20 employees using Single Touch Payroll software
- Annual income tax returns to the ATO
- Reportable fringe benefits to the ATO

Reporting requirements for different entities

Australian statutory financial reporting requirements are influenced by the type of the entity.

It is vital that organisations understand their financial reporting requirements and obligations under the *Corporations Act 2001* (Cth) as these will differ between entities.

The process for determining financial reporting obligations for different entities is outlined here.

Financial reporting obligations for different entities	
Step 1	Categorise the entity. Is it a large publicly listed company? Is it a small proprietary company?
Step 2	Understand the reporting mandate. In addition to the requirements of the Corporations Act, some entities have extra reporting considerations arising under other mandates such as the 'general purpose financial statements' requirement under the <i>Tax Administration Act 1953</i> (Cth).
Step 3	Determine which type of financial statements should be prepared. Once an entity has determined if it is required to prepare an annual report under the Corporations Act, it can then determine which financial reporting requirements to apply under the Australian Accounting Standards.
Step 4	Understand the key requirements for financial statements. This includes the layout and composition of the financial statements.
Step 5	Consider other financial reporting obligations. Once the key financial report has been prepared, entities should consider other reporting obligations such as continuous disclosure, half-year reporting, concise financial reports and relevant financial reporting.
Step 6	Consider new and changed requirements since last reporting period. Consider regulatory changes, other legislative changes and global trends.
Step 7	Access the relevant model financial statements. Based on the analysis performed, the relevant model financial statements can be obtained.

Example

Appropriate financial reports

Rani 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. She prepares a monthly variance analysis and provides a report on any variations to her general manager.

Rani provides a comment against any variation in the report. Where there are significant variances, she researches the situation and recommends contingency plans that could be considered for continuous improvement purposes.

Rani also does a trend analysis so she can consider the income and expenditure over the preceding months to determine whether there is a developing trend. If appropriate, she also compares each month's financial position against year-to-date data.

The general manager must be able to access the findings in Rani'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. Reports on the following websites show how different organisations format different reports and give an overview of their financial summary statements.

Here are some examples:

- BHP, Reports and presentations: aspirelr.link/bhp-reports-presentations
- World Vision, Annual Reports and Program Reviews: aspirelr.link/world-vision-annual-reports

Practice Task 7

Question 1

What statutory reporting requirements exist for a small Australian proprietary company that is registered for goods and services tax and employs under 20 staff? Tick all that apply.

- Annual audited financial statements to ASIC
- Quarterly business activity statement
- Single Touch Payroll reporting
- Annual income tax return
- Monthly sales reports

Question 2

What is the full name of the Australian Accounting Standard that prescribes the basis for presentation of general purpose financial statements? What entity enforces the standard?

3B Prioritise significant issues and prepare financial recommendations

Identifying significant issues from the analysis of the financial statements is a major part of providing financial business recommendations.

If, for example, an organisation experiences consistently low profit margins or unfavourable cashflow variances, two techniques can be deployed: budgetary variance analysis and horizontal analysis.

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.

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 does not 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

Analysing financial data will help an organisation determine the fundamental issues which contribute to current business performance and financial results. From here, recommendations can be made.

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.

Communicate recommendations

To gain support and approval for financial business recommendations, it is important to communicate the details in a clear and concise manner to key decision-makers.

Your recommendations should make it easy for key decision-makers to understand what changes need to be implemented.

Using active listening skills and open-ended questioning will create opportunities for key decision-makers to give extra input on financial decisions and show their understanding and acceptance.

Clear communication of financial recommendations can be achieved by:

- keeping recommendations brief
- focusing on objective evidence and financial data
- avoiding puffery
- avoiding non-essential information
- providing clear evidence to support your recommendations.

Practice Task 8

Question 1

Number each action from 1 to 5 in the order you would follow to prioritise statement issues.

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

Question 2

When presenting financial bids and estimates to key decision-makers, what communication strategies should you use? List at least three strategies.

Question 3

Which of the following are examples of financial recommendations you could make to improve cashflow? Tick all that apply.

- Enforce credit management policies
- Apply for a loan
- Offer overtime to employees
- Cut non-essential spending
- Increase inventory production to stock up for periods of high demand

3C Evaluate 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 auditors 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 efficacy of financial management processes to enable an organisation to achieve its objectives.

Evaluation process

An evaluation process is a systematic approach to collecting and analysing financial data, to help organisations identify the effectiveness of underpinning financial policies and procedures.

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

Evaluation process	
Plan the evaluation	<ul style="list-style-type: none"> Identify the participants in the evaluation process. Identify criteria to guide the development of checklists and timelines. 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 clarify actual practice, and comparing actual practice to procedures. Identify the information needs and who will source policies, procedures and other relevant information to do the evaluation. Identify the actual tasks required to do the review, considering the techniques, tools and timing. Assign employees to tasks and deadlines for task completion.
Gather information	<ul style="list-style-type: none"> Collect the data through review of relevant documentation, interviews and questionnaires. Organise the data. Examine collected information.

Evaluation process	
Analyse information	<ul style="list-style-type: none"> Brainstorm information with the team. Compare information with evaluation criteria. Identify root causes of issues through cause and effect analysis. Prioritise issues. Identify areas where processes are effective and consider using this information to improve areas with issues or that could be improved.
Develop recommendations and plan improvements	<ul style="list-style-type: none"> 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 needed. Prepare an action plan for improvement. Assign responsibilities to tasks needed to implement improvements, which may involve development of new policies and procedures to maximise efficiency and accuracy, purchase of new software add-ons to improve reporting etc. Seek approval from relevant senior management.
Implement and monitor improvements	<ul style="list-style-type: none"> Implement the approved action plan. Ensure relevant staff are aware of changes and organise any training needed in new procedures. Monitor performance according to identified timelines. Assess the effectiveness of improvements.

Financial analysis is 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
<ul style="list-style-type: none"> 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 done 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 of undertaking review, evaluation and audit processes is to promote greater accountability and transparency within an organisation's financial operations. If done correctly, these financial tools give managers a professional financial second opinion on financial planning and managing operations, and thus support them to enhance organisational financial results.

Review the following websites to see examples of how financial reviews, evaluations and comprehensive audits of financial management processes are done in various industries.

Examples of organisational approaches to reviews, evaluations and/or comprehensive audits of financial management processes:

Myer Holdings Limited, 'Audit, Finance and Risk Committee Charter':
aspirelr.link/myer-investor-media-comm

Panoramic Resources Limited, 'Audit Committee Charter':
aspirelr.link/panoramic-resources-charter

CQUniversity Australia, 'Financial Management Practice Manual (FMPM)':
aspirelr.link/cqu-policies-procedures

Here are some websites with guidelines on the evaluation of and improvements to financial practices.

Examples of organisational guidelines for evaluating and improving financial practices:

- International Federation of Accountants, 'Evaluating and Improving Internal Control in Organizations': aspirelr.link/ifac-internal-control
- Queensland Government, Queensland Treasury, Financial Accountability Handbook, 'Monitoring and Assessment of Internal Controls': aspirelr.link/qld-gov-internal-control

Practice Task 9

Question 1

Why is it important to regularly evaluate the effectiveness of financial management processes?

Question 2

Number each step from 1 to 5 in the order you would follow to evaluate the financial management process.

- Implement and monitor improvements
- Develop recommendations and plan improvements
- Plan the evaluation
- Assess the likelihood of the issue affecting activities
- Analyse information

Question 3

What is financial probity and how can it be upheld in business?

Summary

- 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 content and format.
- In offering financial business recommendations, managers first need to assess significant issues from the analysis of the financial statements.
- Techniques for identifying significant issues in financial statements include budgetary variance analysis and horizontal analysis.
- Ratio analysis helps managers make recommendations to senior management based on the organisation's performance.
- Recommendations should be considered in light of internally implemented control measures and prepared contingency plans.
- 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.
- The evaluation of processes involves a review of existing practices and controls, and planning, implementing and monitoring actions for improvements.

Learning Checkpoint 3

Report on finances

Part A

1. Draw a line to match each financial decision or recommendation to a form of evidence that could be used to support your recommendation.

» Recommending particular investment pathways

» Budget analysis

» Encouraging shareholders to purchase more stock

» Forecasts and estimates

» Justifying increases in production to meet increased demand

» Ratio analysis

» Preparing bids for new contracts

» Taxation and statutory returns in an audited annual report

» Enforcing credit management actions to increase cashflow

» Margin, break-even and return on investment analyses

2. Which of the following statements about identifying and prioritising financial issues are correct? Tick all that apply.

- Vertical analysis is used to identify issues in financial statements by showing changes in the amounts of corresponding financial statement items over a period of time.
- Active listening and brainstorming are two ways to involve other managers in the process of prioritising significant issues.
- The role of financial analysis is to provide the evidence for the recommendations or contingencies developed.
- Managers can prioritise significant issues by starting to consider their impact on achieving organisational objectives and using risk management principles to plan responses.

3. List eight examples of organisational and statutory reporting requirements.

Part B

Read the case study, then answer the questions that follow.

Case study

Derek is the finance manager for an industrial fasteners company in eastern Victoria.

It is the first week of October and Derek is busily preparing the quarterly organisational and statutory reports. A board meeting has been scheduled for the 15th of the month and Derek must review the organisational reports to be ready for discussion with the board.

After producing general purpose and departmental reports from the accounting system, Derek sets about systematically analysing them for any issues. During his review, he notices that raw material purchases have exceeded budget by almost 79 per cent for the quarter. On investigating the audit trail, Derek discovers that unauthorised purchase orders have been submitted to multiple suppliers. On further investigation Derek also notices that the procurement policy and procedure manual does not stipulate authorisation processes for purchase orders.

Derek documents his findings in preparation for the board meeting, including a summary of recommendations to avoid this from happening in the future and an evaluation on the effectiveness of current financial management processes.

1. Has financial probity been upheld in the case study above? Explain your answer.

2. When evaluating the effectiveness of controls to prevent overspending, what should Derek be looking for? Tick all that apply.

- Is there adequate segregation of duties for placing purchase orders?
- Are effective procurement policies and procedures in place?
- Are employees trained in the correct procedures for placing purchase orders?
- Is the company meeting its statutory reporting requirements?
- Are regular internal and external audits being done to improve processes and practices?

3. What strategies should Derek use to effectively present his recommendations to the board? Tick all that apply.

- Using puffery
- Written communication forms for large volumes of information
- Sharing his assumptions and 'gut feelings'
- Clear evidence to support his recommendations
- Open-ended questioning and active listening to confirm the board's understanding

