

BSBFIM501

Manage budgets and financial plans

Release 1

Learner guide

BSBFIM501

Manage budgets and financial plans

Release 1

Learner guide

Aspire Version 1.1

Copyright Warning

**This product is copyrighted to Aspire Training & Consulting
(ABN 51 054 306 428).**

Aspire Training & Consulting owns all copyright to its products. Except as permitted by the *Copyright Act 1968* (Cth) or unless you have obtained the specific written permission of Aspire Training & Consulting, you must not:

- reproduce or photocopy this product in whole or in part
- publish this product in whole or in part
- cause this product in whole or in part to be transmitted
- store this product in whole or in part in a retrieval system including a computer
- record this product in whole or in part either electronically or mechanically
- resell this product in whole or in part.

Aspire Training & Consulting:

- invests significant time and resources in creating its original products
- protects its copyright material
- will enforce its rights in copyright material
- reserves its legal rights to claim its loss and damage or an account of profits made resulting from infringements of its copyright.

Aspire is committed to developing quality resources that meet the needs of our customers. However, occasionally Aspire finds, or is notified of, errors. Please refer to our website at www.aspirelr.com.au to see if there are any updates that may be relevant to you.

Every effort has been made to ensure the information in this book is accurate; however, the author and publisher accept no responsibility for any loss, damage or injury arising from such information.

Except where an information source is acknowledged, the names and details of individuals and organisations used in examples are fictitious and have been devised for learning purposes only. Any similarity to actual people or organisations is unintentional.

All websites referred to in this unit were accessed and deemed appropriate at time of publication.

Aspire Training & Consulting apologises unreservedly for any copyright infringement that may have occurred and invites copyright owners to contact Aspire so any violation may be rectified.

BSBFIM501 Manage budgets and financial plans Release 1

© 2017 Aspire Training & Consulting
Level 1, 464 St Kilda Road
MELBOURNE VIC 3004 AUSTRALIA
Phone: (03) 9820 1300

First published April 2017

Cover design: Rewind Creative
Printer: Doculink Australia Pty Ltd, 1d/28 Rogers Street, Port Melbourne VIC 3207

e-ISBN 978-1-76059-363-6 (PDF version)
ISBN 978-1-76059-362-9

Contact details

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

Contents

| | |
|---|------------|
| Before you begin | vii |
| Topic 1: Plan financial management approaches | 1 |
| 1A Access budget/financial plans for the work team | 2 |
| 1B Ensure budget/financial plans are achievable, accurate and comprehensible | 8 |
| 1C Negotiate any changes required to plans | 13 |
| 1D Prepare contingency plans in the event that initial plans need to be varied | 18 |
| Summary | 24 |
| Learning checkpoint 1: Plan financial management approaches | 25 |
| Topic 2: Implement financial management approaches | 37 |
| 2A Disseminate relevant details of the agreed budget/financial plans to team members | 38 |
| 2B Ensure team members perform financial tasks competently | 41 |
| 2C Use resources and systems to manage financial management processes | 73 |
| Summary | 80 |
| Learning checkpoint 2: Implement financial management approaches | 81 |
| Topic 3: Monitor and control finances | 93 |
| 3A Implement processes to monitor actual expenditure and to control costs across the work team | 94 |
| 3B Monitor expenditure and costs on an agreed cyclical basis | 97 |
| 3C Implement, monitor and modify contingency plans as required to maintain financial objectives | 107 |
| 3D Report on budget and expenditure in accordance with organisational protocols | 112 |
| Summary | 117 |
| Learning checkpoint 3: Monitor and control finances | 118 |
| Topic 4: Review and evaluate financial management processes | 125 |
| 4A Collect and collate data for analysis | 126 |
| 4B Identify the effectiveness of financial management processes | 131 |
| 4C Implement and monitor agreed improvements | 138 |
| Summary | 141 |
| Learning checkpoint 4: Review and evaluate financial management processes | 142 |

Before you begin

This learner guide is based on the unit of competency *BSBFIM501 Manage budgets and financial plans*, Release 1. Your trainer or training organisation must give you information about this unit of competency as part of your training program. You can access the unit of competency and assessment requirements at: www.training.gov.au.

How to work through this learner guide

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

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



Foundation skills

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

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

| Foundation skill area | Foundation skill description |
|----------------------------|--|
| Reading | <ul style="list-style-type: none"> Interprets and analyses information to determine activities required |
| Writing | <ul style="list-style-type: none"> Records information in correct forms and prepares materials which convey detailed and factual content in accordance with internal procedures |
| Oral communication | <ul style="list-style-type: none"> Presents information about financial issues and requirements to a range of audiences using structure and language to suit the audience Uses active listening and questioning to clarify information and to confirm understanding |
| Numeracy | <ul style="list-style-type: none"> Uses a wide range of mathematical calculations to analyse numeric information in budgets or financial plans |
| Navigate the world of work | <ul style="list-style-type: none"> Recognises, understands and adheres to organisational requirements in undertaking own work |
| Interact with others | <ul style="list-style-type: none"> Uses a range of strategies to connect, collaborate and cooperate with other work colleagues in activities requiring collective effort and diverse skills and knowledge |
| Get the work done | <ul style="list-style-type: none"> Uses logical processes in planning, implementing and evaluating complex tasks and developing alternative strategies in achieving goals and timelines Uses a range of digital technologies to access, filter, compile, integrate and logically present complex information from multiple sources |

What do you already know?

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

| Topic | Key outcome | Rate your confidence in each section |
|---|--|--|
| Topic 1 Plan financial management approaches | 1A Access budget/financial plans for the work team | <input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident |
| | 1B Ensure budget/financial plans are achievable, accurate and comprehensible | <input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident |
| | 1C Negotiate any changes required to plans | <input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident |
| | 1D Prepare contingency plans in the event that initial plans need to be varied | <input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident |
| Topic 2 Implement financial management approaches | 2A Disseminate relevant details of the agreed budget/financial plans to team members | <input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident |
| | 2B Ensure team members perform financial tasks competently | <input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident |
| | 2C Use resources and systems to manage financial management processes | <input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident |

continued ...

... continued

| Topic | Key outcome | Rate your confidence in each section |
|--|---|--|
| Topic 3 Monitor and control finances | 3A Implement processes to monitor actual expenditure and to control costs across the work team | <input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident |
| | 3B Monitor expenditure and costs on an agreed cyclical basis | <input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident |
| | 3C Implement, monitor and modify contingency plans as required to maintain financial objectives | <input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident |
| | 3D Report on budget and expenditure in accordance with organisational protocols | <input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident |
| Topic 4 Review and evaluate financial management processes | 4A Collect and collate data for analysis | <input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident |
| | 4B Identify the effectiveness of financial management processes | <input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident |
| | 4C Implement and monitor agreed improvements | <input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident |

Topic 1

Plan financial management approaches

To successfully manage your organisation's or team's financial resources, you need to be familiar with the organisation's priorities and objectives for the short- and long-term as articulated in its strategic plans, and understand how these are translated into the resulting organisation budget and then into team budgets. Your role is to support team members by explaining the team's budget to them and ensuring this will help them achieve their goals. Any variations or events that impact the budget need to be identified, documented and negotiated promptly with appropriate personnel within the organisation, such as accountants, frontline managers and supervisors.

In this topic you will learn how to:

- 1A Access budget/financial plans for the work team
- 1B Ensure budget/financial plans are achievable, accurate and comprehensible
- 1C Negotiate any changes required to plans
- 1D Prepare contingency plans in the event that initial plans need to be varied

1A

Access budget/financial plans for the work team

Most organisations develop a range of plans to manage their operations. These might include strategic, tactical, operational and financial plans, all of which include budgets. The plans that are developed may have short- or long-term time lines ranging from several years to a year, quarter, month or week.

Organisations vary in the way they present their objectives and strategic plans, but most develop a business plan that sets the future direction for the organisation by forecasting likely revenue and expenditure and setting financial targets; a strategic plan that breaks down the business plan and determines the major courses of action including key resource allocations; operational plans that relate to the day-to-day activities to achieve the strategic objectives and to measure the organisation's actual financial performance against targets.

You may like to refer to a comprehensive book on the fundamentals of financial management. Chapters 1–4 are of particular relevance to this unit of competency:

Brigham E & Houston J (2010), *Fundamentals of financial management*, 12th edn, Thomson Higher Education, Ohio, USA.

Also, the Australian/New Zealand Standard, AS/NZS 4360:2004 Risk Management, contains substantial information on qualitative and quantitative data analysis techniques for assessing risk. (Note: it needs to be purchased).



Budgets

A budget provides financial targets or allocations against which the success of a plan and its parts can be measured over a particular time frame. Budgets can be set for various component parts of the business of the organisation such as a sales budget, a labour budget, inventory budget or operating expenses budget.

Budgets should be part of each department or cost centre of an organisation. They need to reflect the needs, inputs and outputs of that area and indicate how the department/cost centre contributes to achieving the desired objectives of the organisation.

As shown below, there are two general types of budgets and it is important to understand the difference between them.

Operational budgets

Operational budgets are primarily linked to daily activities that produce revenue. These budgets can include the cost of producing goods for sale and the expected return from the sale of these goods, and therefore include the cost of inputs (for example, labour and other materials in producing the goods, the cost of storage and transport of the goods) and ultimately the income derived from the sale of them.

Financial budgets

Financial budgets are also called financial plans. They are focused on obtaining funds (cash) and the use of those funds for the advantage of the organisation. These budgets include the cost of finance in relation to the cost of obtaining capital through borrowing or other mechanisms; for example, capital raising through the sale of shares.

Understand financial plans

It is your job to access and familiarise yourself with the following financial plans so you can explain them to members of your work team. In this way, they can understand the goals and objectives they are expected to achieve and the financial boundaries within which the team must operate. Make sure you are familiar with, and can clarify with team members, relevant terminology such as cashflow, profit and loss, balance sheet, financial statement, capital expenditure, assets and liabilities, depreciation and lease versus purchase.

The types of financial plans and budgets utilised depend on the size and nature of the business. Below are some definitions and explanations of budgets, plans and projections.

Strategic long-term budgets/plans

Long-term budgets and plans are closely allied to an organisation's strategic goals and objectives. They are generally developed for a five- to ten-year period.

Short-term and operational budgets/plans

Operational plans relate to the ongoing day-to-day and weekly activities of an organisation. They are focused on the operational side of a business in terms of achieving short-term goals and objectives associated with the expected expenditure and income of the organisation's goods and services.

Operational plans are short-term plans that generally relate to an organisation's financial year. A significant part of this process is managing the budget on a day-to-day basis.

Cash budget or cashflow projections

Cash budgets detail the expected cash/funds coming in and cash/funds going out for payments over time. A negative position indicates cash is not available to pay accounts and thus additional monies may be required or action taken to delay some payments.

Spreadsheet-based financial projections

In developing inputs, parameters for operational and financial budget spreadsheet models are often developed to provide a picture of the expected sales and expenditure for various departments or entities of an organisation. They can be used to set targets that are required in meeting sales objectives, expected expenditure and, therefore, profit. By using the 'what-if' approach in changing various parameters, such projections can be useful in providing guidance on the position of the organisation at some future point in time.

Other budgets

There are also other types of budgets that you may come across. Some of these are described below.

Sales or revenue budget (expected income)

This is the first budget that should be developed as it impacts many others. It is used to document the expected income from the sale of goods and all other income sources such as service fees, investment income, donations (if applicable) and grants. It is called a revenue budget when there is effectively no sale of goods as part of the business.

Costs of goods/services sold budget

This budget is developed from the expected cost of goods/services that are expected to be sold at a profit.

Production cost budget

Production cost budgets are an accumulation of three budgets:

- Labour expenses budget for staffing inclusive of recruiting staff, paying superannuation, leave liabilities; for example, recreational and long service leave.
- Material purchases budget that takes into account the expected goods and services sold and the raw materials required, plus costs associated with production, storage and transportation.
- Overheads budget for such items as cleaning, tea/lunch room facilities.

Capital expenditure budget

Capital expenditure budgets are for assets that are deemed to be capital in nature and are used over many budgeting periods. They include plant and equipment, buildings and vehicles.

Operating expenses budget

This budget includes expenses such as travel, advertising and promotion that are related to the sale of the goods and services produced.

Inventory budget

An inventory budget identifies materials kept in stock for use in manufacturing to meet the demand for the production of goods, as well as the finished products or goods held to meet demand from buyers.

Financial statement (budget)

Financial statements are documents (budgets) that reflect the gross and net profit on goods sold. A balance sheet (statement of financial position) can be developed as a budget to reflect the expected position of an organisation at the budgeting period; for example, end of financial year.

Targets and key performance indicators

Targets or key performance indicators (KPIs) are developed to measure business performance and progress towards the objectives of the organisation. They are designed to ensure that the day-to-day activities are being achieved and are contributing to the organisation's goals.

KPIs are often based on the expected outcomes detailed in the budgets; for example, cashflow projections are based on expected sales, which in turn set a target or KPI for the sales personnel to achieve a certain level of sales.

Organisations generally set targets or KPIs and record the outcomes for:

- production
- productivity
- resource utilisation and wastage
- sales
- income, expenditure and profitability
- performance and attitude of employees and performance improvement of managers
- public and environmental responsibility.

Access budgets/plans and financial information

Organisational and team budgets are developed by senior management then disseminated to team members through their manager for discussion. You need to know where these budgets and financial plans are kept so they can be easily accessed when needed. In some circumstances, sensitive financial plans may be confidential and only available to senior staff, so be aware of the type of information you can discuss with your team.

Operational budgets are usually kept by the manager and shared with team members so they can set relevant targets or KPIs to be achieved and discuss the team's responsibilities in meeting the budget.

You may like to read a comprehensive book on budgeting:

Shim JK & Siegel JG 2012, *Budgeting basics and beyond*, 4th edn, John Wiley & Sons, New Jersey, USA.



Example: use a team approach to budget development

Jessica works as the manager of a branch of an employment service that has 12 branches across northern New South Wales. Her office is based in a rural town of approximately 15,000 people; the office also services the surrounding rural community. The strategic plan for the whole organisation is prepared at the head office in Newcastle with input from all managers.

The plans and budgets that Jessica prepares for her office with her team of staff each year are as follows:

- Revenue budget based on fees charged
- Production costs budget that includes a labour expenses budget for staff (including some casuals) and an overheads budget to cover the rental of premises and a cleaning contractor
- Operating expenses budget
- Financial statement budget consisting of a budgeted profit-and-loss statement and a budgeted balance sheet
- Cashflow plan

Once the budgets have been developed and approved, they are kept in Jessica's office as a hard copy and on the information system of the organisation. Jessica's team has access to these documents, subject to the security level attached to each budget and the level of responsibility and level of authority of team members.



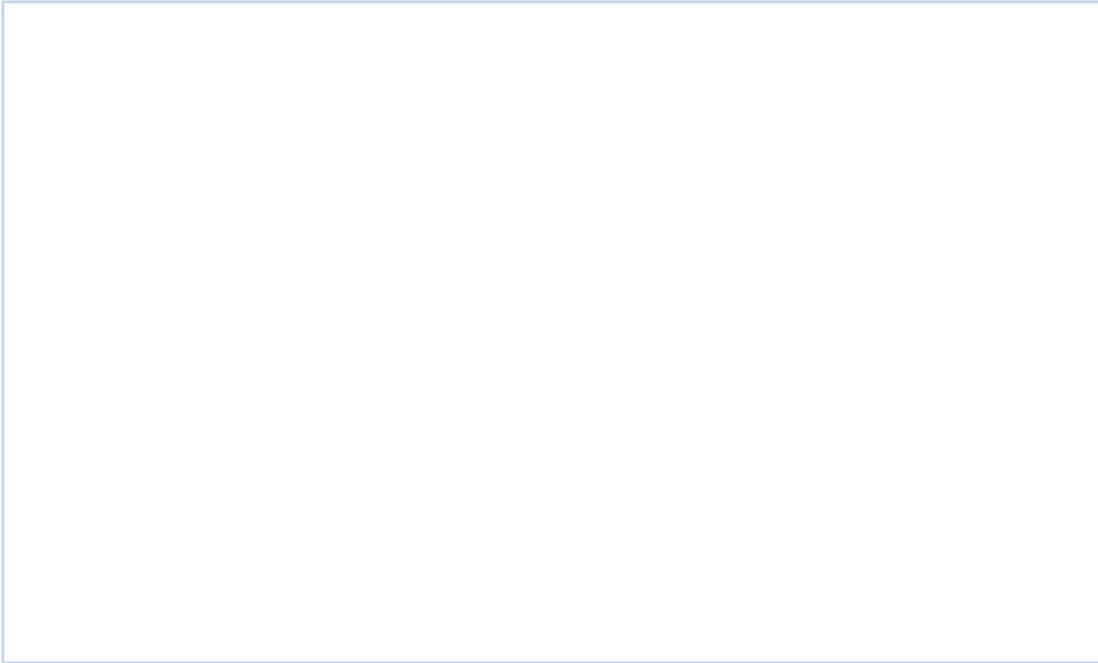
Practice task 1

Document the following for an organisation you are familiar with.

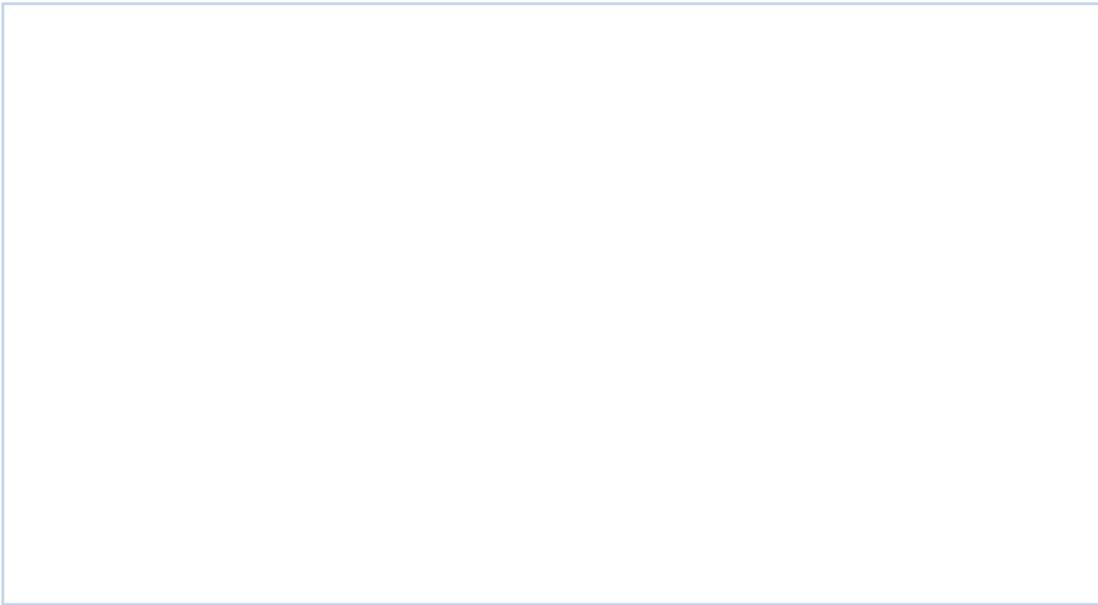
1. A list of the various financial plans that are developed on an annual basis including a comment on their relevance.

continued ...

... continued



2. A list of the KPIs used and their relevance.



1B

Ensure budget/financial plans are achievable, accurate and comprehensible

The budgets and financial plans developed by an organisation primarily depend on the size of the organisation and the type of business involved; for example, whether it is a service organisation that charges for its services, a trading organisation that buys and sells goods or a manufacturing organisation that buys raw material and converts it into a saleable product. Because of the significant differences that exist between the three types of organisations so too are the range of budgets developed for each one.

Whatever type of financial plans are developed they must be clearly written, concise, and accurate; the documented outcomes should be achievable, with contingencies in place as a risk-control measure.



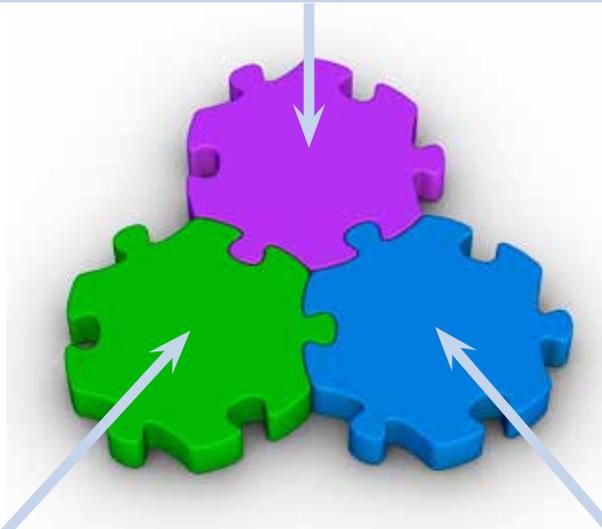
Confirm the plan

You may be responsible for developing a budget or financial plan for your own cost centre or work team, or for implementing one that has already been prepared by a financial expert in the organisation. In either case, you need to understand the plan and be sure that it is presented according to the organisation's layout requirements, is written in plain English, is clear in its intent and all information, and projections and calculations are accurate.

To do this you may need to consult with relevant personnel, such as financial managers, accountants and financial controllers, who are well aware of the broad directions of the organisation and the potential impacts on cost centres other than their own. In addition, you may need to talk with supervisors and other frontline managers. Your goal is to ensure the plans are achievable, comprehensible and accurate as explained here.

Comprehensible

You need to ensure that the budget is understandable and logical so that all members of the team know what is required and that all aspects are covered. For example, if the budget has allowed for new equipment, check that it clearly states that there is money for training staff and for ongoing maintenance. Each team member needs to know the various sections of their activities that the budget covers. Make sure the budget includes any supporting information, such as spreadsheet projections of targets, so that everyone can see the current picture and how their work helps the organisation meet its financial goals. Any jargon or terminology used should be clearly defined.



Achievable

You need to ensure that the capabilities of your area of responsibility and those of your team can deliver the required goods and services within the estimated budget. For example, if you are expected to deliver 100 units of a manufactured product per week, you must confirm that the team is properly resourced with the appropriate equipment and available labour to do so; if the budget has only allowed for one additional parttime staff member to be engaged for a project, you need to know that this is sufficient to enable the team to deliver on time.

Accurate

You must make sure that the estimates on expenditures and income are a true reflection of the expected costs and revenues; for example, is the quantity and price per tonne of raw materials being used correctly; can such a quantity be safely stored; are all projections based on correct calculations?

Consult with others

Be aware of the people who have responsibilities for financial planning within your organisation. Be clear about your own role and who you are accountable to, regardless of whether you are in charge of producing a budget, contributing to the preparation of a budget or implementing an agreed budget. Here are some financial roles and associated tasks.

Financial managers

Large organisations have a financial or accounts manager who takes responsibility for financial control including budgets and budgetary expenditure. This person prepares budgets for all areas and invites input from line managers with the opportunity to negotiate for their particular department or section.

Finance support staff

Finance staff assist the finance manager and area managers to develop a budget. Depending on the organisation, they:

- provide financial information and advice to budget managers to ensure budgets meet organisational targets
- analyse submitted budgets to ensure they are accurate and achievable
- resolve issues
- assist with regular monitoring and reviewing.

Budget managers (area or departmental managers)

In smaller organisations, it may fall to each area manager to prepare and implement a budget under the direction of the chief executive officer or director of the company. Budget managers:

- consider the impact of their budget development on other areas of the organisation
- liaise and consult with finance staff and other managers to ensure the budget is accurate and targets can be met
- submit accurate and appropriate budgets
- implement the agreed budget.

Consult about budgets

If you are helping to develop a budget you should have regular meetings with relevant personnel, so you can see how the budget will impact your area and provide feedback from your own perspective and experience. You can explain whether you think your team can achieve the budget. You also have the opportunity to ensure that calculations involving estimates and targets are correct, so that the financial resources allocated to your team are appropriate and used effectively. Having regular input gives you more ownership of the plans and means you can explain them more clearly to your work team.

If you are clarifying with financial experts a budget or plan that has already been developed, be prepared for the consultation. Have questions ready for what you want to know. Be prepared to explain why you think an item may not be achievable. If you are having difficulty with jargon or unfamiliar phrases or words, don't be afraid to ask. You will learn more about financial management with practice and experience.

You may like to read a book that examines key issues in managing and leading teams:

Lencioni P 2002, *The five dysfunctions of a team: a leadership fable*, Jossey-Bass, San Francisco, USA.

Example: range of cost centres and budget processes

A large tertiary institution has a well-defined budget process in that all cost centres are advised of their allocation of the expected income for the forthcoming year. In addition to the six faculties as teaching cost centres, more than ten other cost centres also exist, such as Finance, Student Administration and Information Technology.

Many of the cost centres have 'subcost centres' inside them; for example, faculties have schools or departments.

The process is as follows:

- Each budget submission is reviewed by the budget control officer on behalf of the chief financial officer and budget committee.
- Adjustments are made and the budget submitted for scrutiny by the budget committee.
- Each cost centre manager and budget manager (if they are separate positions) have a faceto face interview with the budget committee.
- Matters of concern are clarified with the particular cost centre manager as needed.
- For the large entities, evidence has to be provided that the various 'subcost centre' managers or supervisors have provided input into the overall budget preparation for the cost centre.
- When the cost centre budget is approved it has to be distributed to all relevant personnel in the cost centre for implementation.

Practice task 2

Document the following for an organisation you are familiar with.

1. Classify the organisation as a service, trading or manufacturing organisation.

2. List the specific budgets that are developed and used in developing the overall budget for the organisation.

continued ...

... continued

3. Detail the consultation that needs to take place and highlight those that you have been involved with and why.



1C

Negotiate any changes required to plans

You may believe that a budget is not achievable without further financial resources being made available, or that allocations need to be altered to provide a better balance. In such situations you need to negotiate with others to change part of the budget to ensure you and your team can achieve designated targets. Final approval for your budget remains with the financial manager.

Consultation is a key component of the process in developing accurate and achievable budgets within an organisation.



Budget changes

Changes may need to occur for many reasons, some of which may be out of your control. Often budgets and financial plans span more than one area and the responsibilities for the budgets sit with more than one person. External decisions can impact an organisation and, consequently, its total budget. In many cases organisations have a contingency fund for adjusting budgets when necessary.

Below are a number of reasons why budgets may have to be changed after they are put together.

Making changes to a budget

- Initial costings have proven inadequate or inaccurate.
- A new staff member is required but not included in the budget.
- The time allocated to tasks is unrealistic.
- Wage rises dictated by government or union action have increased staffing costs.
- There is a corporate directive to reduce expenditure in all areas.
- There have been significant increases in supplier costs.
- A new, compulsory initiative that has not been budgeted for has to be implemented.

Options for changing budgets

You need to be familiar with a range of options, so you can successfully discuss the budget change with team members and offer suggestions that the team is happy with.

These options may include:

- allocating additional funds from the organisation's contingency fund
- reducing overtime availability
- saving salary through reducing hours
- delaying the purchase of new or replacement equipment
- hiring temporary staff for a short period
- dropping a training initiative
- reducing the number of products manufactured.

Consult as part of the budgeting process

Part of the budget development process may require some give and take in negotiating the budget plans for the forthcoming year and making adjustments to the budget as the development process continues.

Budget decisions and issues should be discussed with relevant people in the organisation as the budget is being developed. Make sure you understand the time frame for preparing the budget, so that you have time to discuss issues with others and adjust or prepare contingencies.

Be sensitive when discussing proposed budgets as some issues may be confidential at the time the budget is being prepared; for example, a budget may reflect a structural change in a particular cost centre where positions may be lost.

Others you may have to consult with when working with budgets include specialist budget and finance personnel, other managers and your team members.

Consult with budget and finance personnel

Any budget you prepare impacts other budgetary issues and financial plans within other sections of the organisation, so you need to be aware of the issues you wish to raise with the organisation's financial manager. Any changes you may propose to a budget will similarly impact others. Those responsible for the overall budget of the organisation are aware of this. They are also aware of the extent of the organisational expenditure on common goods and services such as stationery, travel and computer equipment. Such information may enable you to combine with others to seek reduced costs by coordinating purchases and buying in bulk, or delaying payment terms that could assist with cashflow.

Consult with managers

You may need to speak with other managers in the event that decisions and changes in your budget impacts their operational responsibilities, and therefore budgets and financial plans. Negotiation with other managers could include options for sharing resources, such as a person working across two areas by combining two jobs into one and eliminating unnecessary activities.



In a large organisation budget managers and their team rely on the services of other areas. Such services come at a cost and need to be paid for, either as a direct fee for service by payment from one department to another, or in the budget allocation process. For example, a marketing and sales department relies on the information technology (IT) department for hardware and software support. If the managers in the marketing and sales departments were to agree to standardise their requirements, then the IT department may be able to reduce their costs.

Consult with team members

As a manager you will be aware of the importance of consultation and being open with team members, so they understand the budget and how it affects them. If a change has to be made to the team's budget because an inaccurate calculation has affected initial costings, or team members have been given additional responsibilities with no corresponding increase in the budget, consult with them and discuss the impact the change will have. Ask for their ideas for how the team can manage. Consider all feedback and negotiate with the team to achieve a successful outcome. In many cases, there may be no solution that satisfies everyone, so you may have to find ways to support the team as a compromise solution is implemented.



Deal with conflict

Conflict may arise where team members have differing views or are concerned about the impact of options in the area of the organisation in which they are based. Resolving conflict within a team is important as a team must work towards corporate goals and objectives.

Sometimes, the whole organisation may have been asked to make adjustments to cater for a forecast increase in expenditure. Ultimately the aim is to have budgets that meet the organisational objectives, and that the actions required have been discussed, agreed and are presented for approval.

Example: negotiate budgets with others

Sam is the manager of the information technology department that provides services to the rest of the organisation. He has just been asked to reduce expenditure by 10 per cent; which could have a significant impact on the service provision across the organisation.

The actual services to be reduced need to be discussed and negotiated across all departments that may be affected by actions, such as reduced staffing and reduced overtime that results in slower response times and potential down times in production. In this situation, Sam also needs to negotiate the budget with fellow managers and actively consider the various options provided by them. Likewise, he needs to provide options that his team have developed to the other managers.

Approve the budget

Recommended variations and adjustments to budget plans resulting from the efforts of work teams should be reported to the relevant personnel for consideration and approval.

Once financial plans and budgets have been completed for the various cost centres, they are generally scrutinised by senior management or the designated senior planning or financial officer for approval.

Scrutiny by senior management/financial officers involves checking that the budget:

- complies with higher level plans and the organisation's strategic goals and objectives
- agrees with guidelines for setting a budget
- ensures effective and efficient use of resources based on industry benchmarks or organisational experience
- is consistent with all other cost centre budget submissions
- is as accurate as possible.

Example: negotiate to modify a budget

Emma is the manager of a four-member team in a recruitment agency. The budget for the team covers staffing, materials, preventative safety measures and training. After the initial budget is drafted, she recognises that there are not enough funds to implement the professional development program she has hoped for. Her manager asks her to cut back on her proposal, which included three days attendance at a conference and a one-week external training course.

Emma meets with her team to discuss the situation and see how they can retain the professional training and development plan but at a reduced cost. Team members make a number of suggestions. Some of them are upset and annoyed that they have to forego the conference. However, with Emma's guidance and support, they agree to send one person to the conference who will report back to them, and do further costings to see whether hiring a consultant to run training sessions would be cheaper than the planned training course.

Eventually, Emma is able to present a modified budget that fulfils her team's training needs yet is in line with the organisation's overall financial planning.



Practice task 3

You are a manager responsible for the budget for your work team. You are told that your area has been targeted to reduce expenditure by a minimum of 15 per cent. Document your approach to developing an adjusted financial plan/budget for your area.



1D

Prepare contingency plans in the event that initial plans need to be varied

All budgets and financial plans are designed to be a framework within which the organisation works, so when you identify that they are no longer working or you are unable to achieve them, you need to vary or adjust them to meet the new circumstances.

It is good business practice to identify potential risks faced by your area/department in achieving organisational plans; perform a risk analysis and have contingency plans that can be actioned if and when a change occurs. A proactive approach is to incorporate risk management into the planning processes of the organisation and to have options readily available.

Manage risk

The first step in financial risk management is to identify the financial risks that the organisation can face and how these would impact the budget. Then you can identify possible contingencies.

The organisation should undertake a risk assessment and effectively rank each identified risk. Each manager should be part of this process. Commencing with the major risk issue, review the current processes in place for managing that risk to determine if it is appropriately managed. This may involve consultation across a broad range of areas within and external to your organisation. Plans should be prepared to manage or control the risk by reducing its likelihood, or reducing the risk and the impact if it does occur. This information in turn impacts the organisation's budgets and financial plans. Possible risks and risk control measures are outlined in this table.

| Risk | Example | Risk control |
|------------------------|---|--|
| Equipment failure | Regular breakdowns add to the maintenance budget. | Lease equipment |
| Delayed input supplies | Materials not arriving or being held up at customs halt production and impact on cashflow. | Hold greater quantities at an increase in inventory costs |
| Price and cost changes | Increased costs of inputs and unexpected salary increases add to the labour and production and thus cashflow. | Hold greater quantities of inputs or have firmer contractual arrangements in place |
| Staff shortages | Sudden illness or departure impacts on labour costs; you may need to pay other staff overtime to meet production schedules. | Increase in casual/flexible labour |
| Security breaches | Breaches of confidentiality or privacy of clients reduces confidence in the company and reduces demands for goods and services. | Tighter security and confidentiality control measures in place |
| Financial loss | Mismanagement of resources, theft or fraud adds to costs and impacts on cashflow. | Increased security measures |

continued ...

... continued

| Risk | Example | Risk control |
|------------------------------------|---|--|
| Quality control | Poor standard of products sent to market or incorrect advice to clients impacts on demand for goods and the income from sales. | Increased quality control measures in place |
| Environmental impacts | Storms, floods, power failure, water shortages, drought and heat waves impact on production. | Have production spread across several plants |
| Major disasters | An event that causes a serious disruption or termination of operations for a period of time impacts on the budget. | Have alternative locations ready for continuation of the business or as a temporary operational site |
| Competitors' actions | The release of new, better or cheaper product impacts on the demand for goods and thus income. | Have a discount sales campaign |
| Legal and contractual issues | A breach of contract or legal requirement impacts on supply of goods and budget. | Have more detailed contracts and alternative supply options |
| Customer behaviour | Satisfaction ratings or changes in spending habits impact on sales and cashflow. | Increase advertising and promotion |
| Government regulation or behaviour | A ban on advertising a specific product; tax changes such as tax increases on certain products impacts on demand, sales and cashflow. | Have options for discount sales or increased promotional advertising |

Develop contingency plans

Identify solutions to manage the financial risks. Undertaking regular risk assessment analyses and preparing a risk management plan is the first step. Other contingency plans and some strategies are outlined below.

1

Outsourcing

It may be more cost-effective to have an external organisation perform certain operations or produce inputs. Activities that might be considered include:

- bookkeeping
- payroll
- security
- printing
- recruitment.

2**Diversifying outcomes**

Increase the range of products and services produced, or have the flexibility to adjust current production in order to reduce the reliance on a small range of products and services.

3**Cheaper consumables**

Seek lower-cost input options; for example:

- use cheaper or lower-quality raw materials and consumables
- change suppliers
- move some operations offshore
- outsource the production to cheaper producers.

4**Increasing output**

Adjust resources to provide increased effectiveness and efficiencies including:

- buying new machinery
- changing the system of work or changing work layout
- increasing staff
- current staff working more hours
- training staff to multi-skill them
- increasing marketing through advertising or promotion.

5**Recycling and re-using**

Set up systems to obtain greater benefits from inputs by recycling waste, or the ability to re-use various inputs/assets for other purposes.

6**Procurement options**

Reduce large capital outgoings by not purchasing capital items. Instead consider:

- leasing
- renting
- hire purchasing assets to spread the payments over time.

7

Restructuring

Combine similar areas with the intention of obtaining economies of size and economies of scale. Consider multi-skilling so that a person can undertake more than one role thus reducing the need for additional space for staff.

8

Additional funding

Seek additional funding to address shortfalls through:

- refinancing
- extension of time on payments
- obtaining loans and lines of credit
- obtaining potential investors or partners.

9

Reducing costs

Reduce costs or waste through:

- adjusting staff wages, salaries and conditions (benefits)
- reducing staff and/or hours of operation
- changing maintenance schedules but keep within minimum standards
- reducing travel and accommodation
- finding cheaper alternative suppliers.

10

Succession planning

Identify people for future higher roles and provide training and development to manage those roles.

Example: contingency planning

Scenario 1:

An organisation was finding the costs associated with recruiting new staff increasing, mainly due to the time managers were involved in preparing advertisements, reading applications and conducting initial interviews. They decided to trial the outsourcing of recruitment to see if it could reduce the human resources budget.

Scenario 2:

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

Example: negotiate budgetary options

Jeremy is the production manager at a photocopy company. The organisation has prepared a financial plan that asks each manager to reduce costs in specific areas.

Jeremy looks at the draft budget he has been given and discusses the outcome with the company manager. Jeremy notices that his team have to reduce costs in paper supplies and work hard to increase the production target. He has not been given any additional funds for new equipment. The training budget only covers inductions. He negotiates with his manager to increase the training budget as he knows there is a seminar coming up that is valuable to all of his staff. His manager agrees.

Jeremy meets with his team to go through the budget and ensure that everyone understands it and is clear about their responsibilities. He knows they will not be happy with the increased production schedule.

Jeremy explains the budget to the team and gives them a copy.

Together they suggest that:

- new suppliers are sourced to provide cheaper paper so they can meet the budget
- the money allocated to equipment maintenance be increased to ensure they continue to be in good operating order, as no new equipment has been budgeted for
- a small amount of money be allocated to a reward system to motivate production.



Jeremy documents the suggestions and presents these to his manager. After further negotiations, most of his team's requests are approved; the manager decides that the organisation provides sufficient acknowledgment through its reward and recognition program.

Practice task 4

Using an operational plan and budget from an organisation you are familiar with, complete this table. An example has been provided in the first row.

| Risk | Impact on budget | Contingency planning |
|--------------------------------|------------------|--|
| Exceeding budgeted expenditure | Budget overrun | Monitor budget versus actual expenditure regularly to: <ul style="list-style-type: none"> • implement contingency actions to keep budget on track • report to management of projected overrun. |
| | | |
| | | |
| | | |

1. Identify the risks to the organisation or a team/cost centre within the organisation (first column).
2. Explain how the risk is likely to impact the budget if it occurs (second column).
3. Develop an appropriate contingency plan to manage the identified risk (third column).

Summary

1. A budget provides financial targets or allocations against which the success of an organisation's strategic plan and its parts can be measured over a particular time frame. Budgets can be set for various component parts of the organisation's business such as a sales budget, a labour budget, inventory budget or operating expenses budget.
2. Key performance indicators (KPIs) must be determined as a measure of whether cost centres and the organisation are achieving their targets and contributing to the organisation's strategic objectives.
3. Managers must be familiar with where budgets and financial plans are stored so they can access and discuss them with their work team. A manager's role is to support team members by explaining the team's budget to them and ensuring this will help them achieve their goals.
4. Any variations or events that impact the budget need to be identified, documented and negotiated promptly with appropriate personnel within the organisation such as accountants, frontline managers and supervisors.
5. Financial plans and budgets must be clearly written, concise, clear in their intent and all information, projections and calculations be accurate; the documented outcomes should be achievable, with contingencies in place as a risk-control measure.
6. Team managers may need to consult with relevant personnel, such as financial managers, accountants and financial controllers, to confirm aspects of the plan and ensure the budget/plan is achievable, accurate and comprehensible.
7. Consultation, negotiation and communication skills are essential for those involved in budget management. A team manager needs to be able to discuss any issues they have with their budget if they believe it is not achievable or needs to be adjusted.
8. If a manager identifies that the budget or financial plan is no longer working, they need to vary or adjust it to meet the new circumstances.
9. Contingency plans should be developed for possible risks to the budget; these might include outsourcing, finding cheaper materials, recycling, seeking further funding or introducing strategies to reduce costs.

Learning checkpoint 1 Plan financial management approaches

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

Part A

1. Explain in your own words the role of a budget and its relationship with the strategic objectives of an organisation.

2. You have been asked to prepare a document for a new member of staff that describes the various budgets that operate in the business. Ensure that you describe the different budgets detailed below and provide an example of each one.

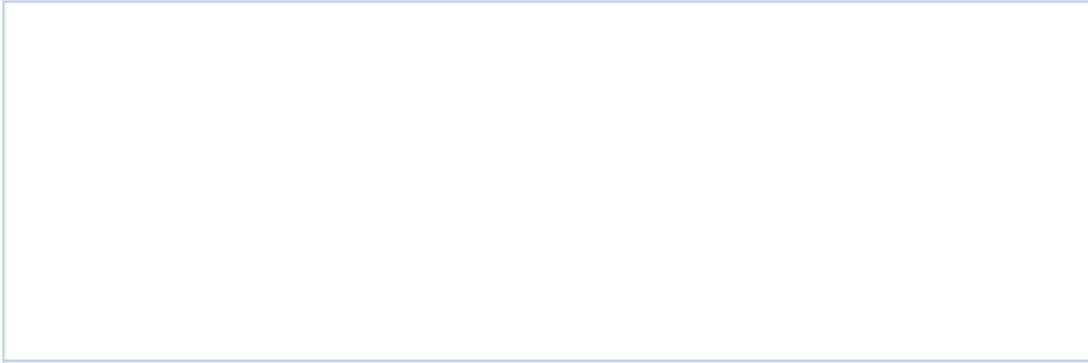
a) Sales budget

b) Revenue budget

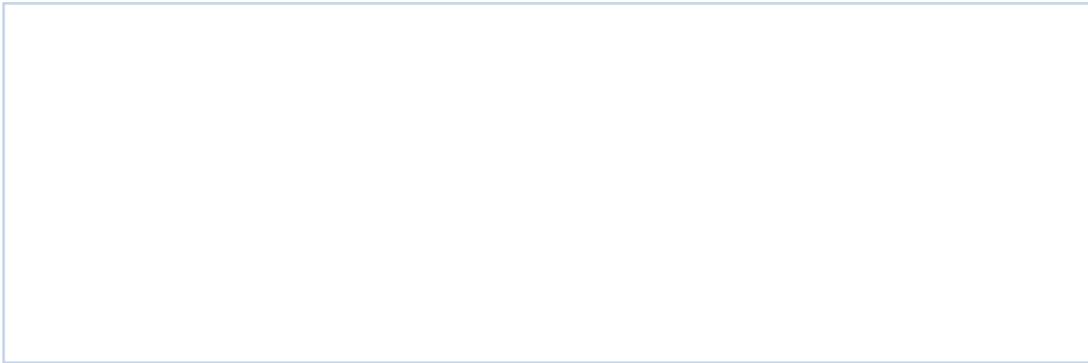
c) Cost of goods/services sold budget

d) Cash budget or cashflow projection

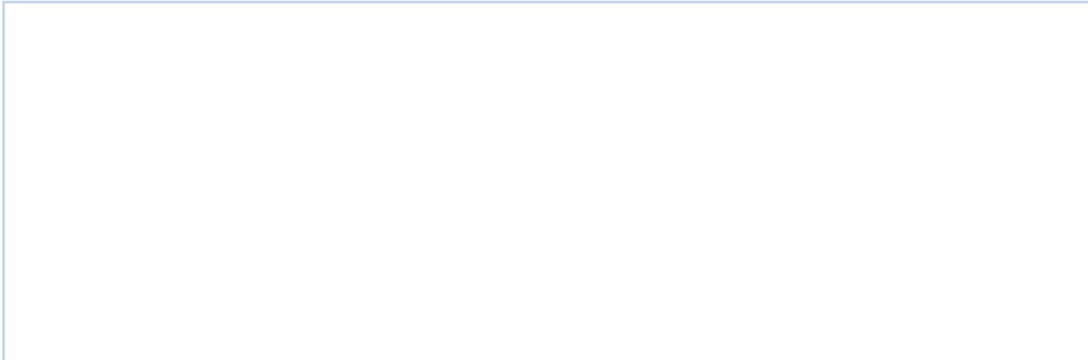
e) Inventory budget



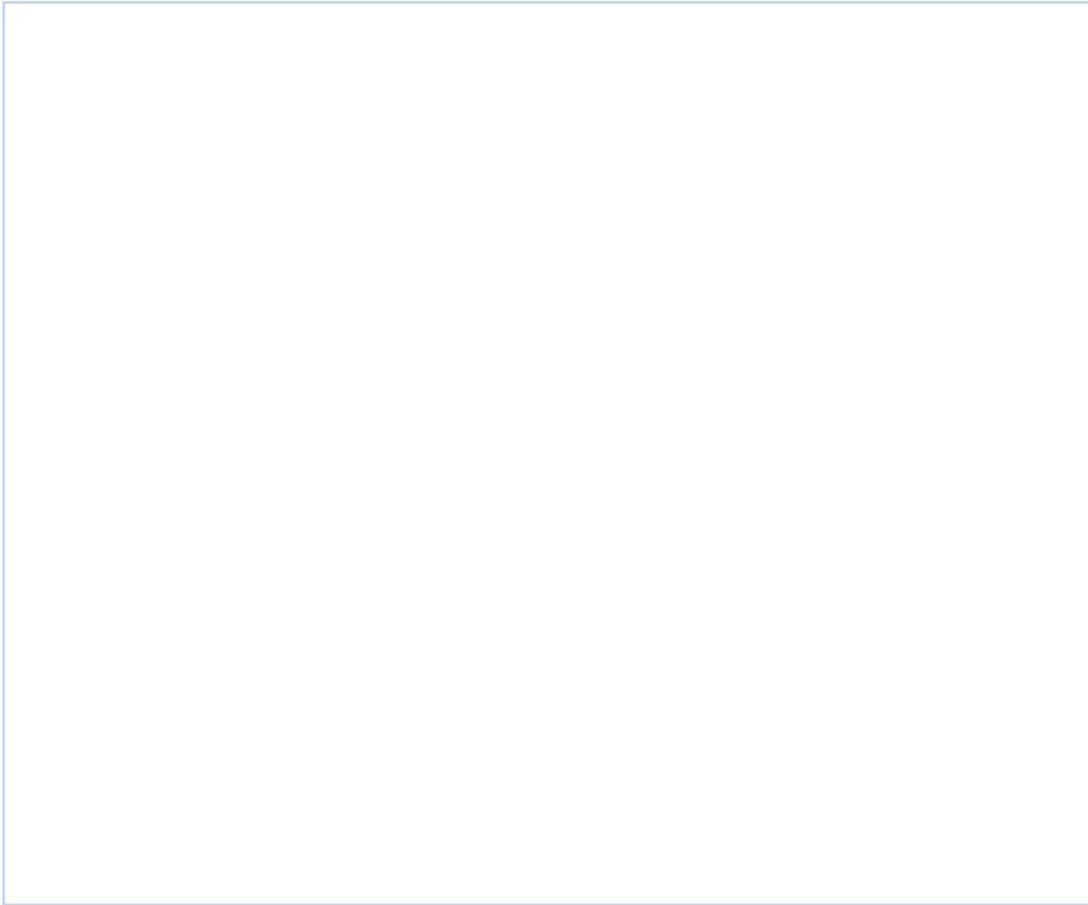
f) Profit-and-loss budget



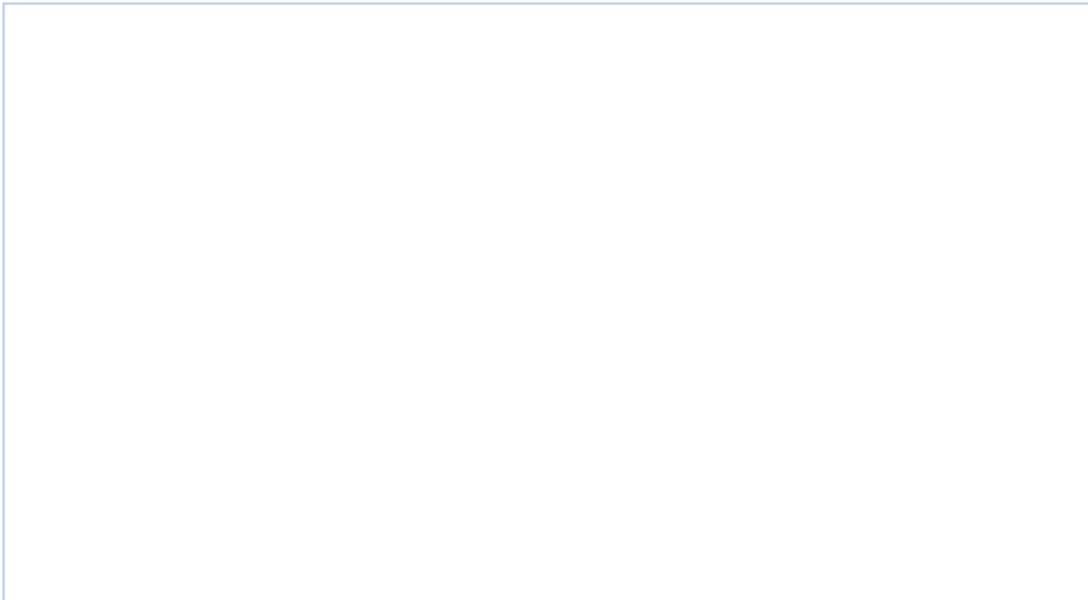
g) Balance sheet budget



3. Outline a budget development process and identify who is involved in the process.



4. Describe the checks that are performed to ensure a budget can be achieved.



5. Select a service, trading or manufacturing business. Identify five direct areas/reasons where you might require a contingency plan; provide an example for each and explain its impact on the budget. Use the following table.

| Contingency for | Strategy option(s) | Impact on budget |
|------------------------------|--|--|
| Increased demand for product | Increase in staff; work more hours; training | Higher wage cost with overtime or additional staff |
| | | |
| | | |
| | | |
| | | |

6. Read the case study, then complete the tasks that follow.

Case study

Hasan works for a company that manufactures shower screens. He is the cost centre manager for the production area. For the four products they manufacture, sales at the end of February are in the table below.

| Product | Unit | Value (\$) |
|---------------|------|-------------------------|
| Basic | 150 | 37,500 (250 per unit) |
| Standard plus | 250 | 125,000 (500 per unit) |
| Deluxe | 200 | 150,000 (750 per unit) |
| Super deluxe | 100 | 100,000 (1000 per unit) |

The above production is standard from month to month and the costs involved are below.

| Product | Labour per unit (hours) | Material cost per unit (\$) | Overhead contribution per unit (\$) |
|---------------|-------------------------|-----------------------------|-------------------------------------|
| Basic | 2.0 | 100 | 10 |
| Standard plus | 3.0 | 250 | 20 |
| Deluxe | 4.0 | 480 | 34 |
| Super deluxe | 5.0 | 600 | 43 |

Labour is costed at \$50 per hour and includes contributions to leave entitlements and superannuation. Material costs are fixed with a supply contract for the standard quantities required each month.

Hasan is advised that the company has just won an extra special order for the supply of shower screens for a refit of a hotel, and the products are required by the end of March. The quantities and agreed per unit price are below.

| Product | Required units | Price agreed per unit (\$) |
|---------------|----------------|----------------------------|
| Basic | 30 | 275 |
| Standard plus | 50 | 550 |
| Deluxe | 10 | 750 |
| Super deluxe | 5 | 900 |

Production for March will now be the usual monthly production as per February above, plus the new contract commitment.

- a) Prepare a sales budget for March using a spreadsheet program based on the table provided below.

| Product | Units | Unit price (\$) | Value (\$) |
|---------------------------------|--------------|------------------------|-------------------|
| Usual monthly production | | | |
| Basic | | | |
| Standard plus | | | |
| Deluxe | | | |
| Super deluxe | | | |
| Total monthly production | | | |
| Special order (March) | | | |
| Basic | | | |
| Standard plus | | | |
| Deluxe | | | |
| Super deluxe | | | |
| Total special order | | | |
| Total March production | | | |

- b) Using the information provided, determine the budgeted cost of production (labour, materials and overheads) and the profit per item that can be expected for the normal monthly production, and for each item to be produced for the special order.

- c) Determine the total labour required for a standard month's production and for the additional production in March. You are advised that the total labour availability is 2,400 hours based on normal working hours. Since the existing labour force is nearly fully utilised, are there any issues for Hasan? If so, what options would you investigate and what would you recommend, given that overtime is costed at \$75 per hour?



- d) What other issues might Hasan face? List at least three. For each issue, suggest a contingency plan that you would expect to be in place.

Part B

Complete either Question 1 or Question 2.

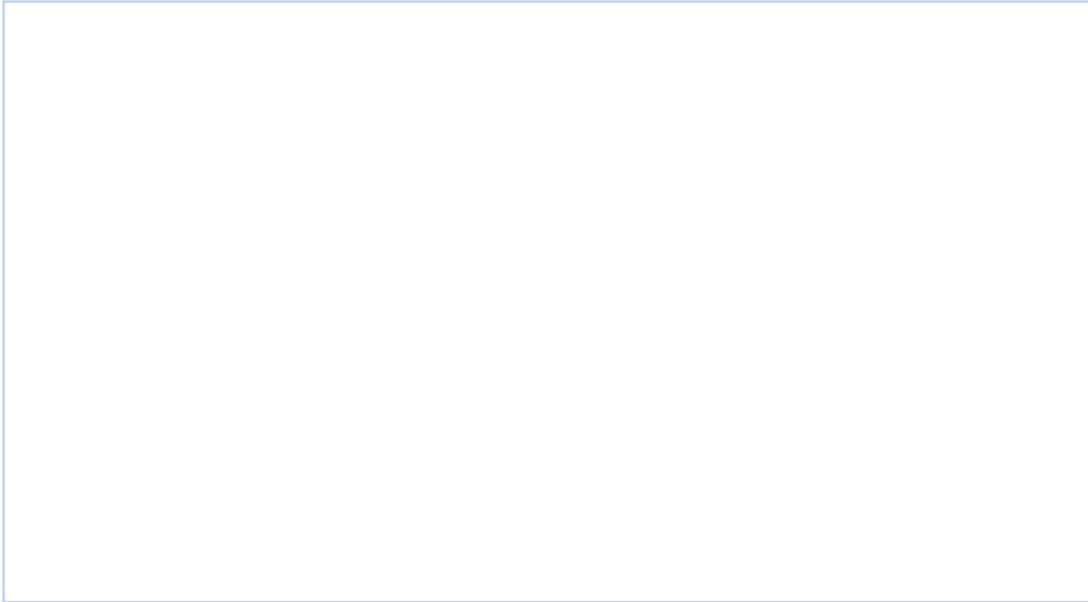
1. Read the case study, then complete the tasks that follow.

Case study

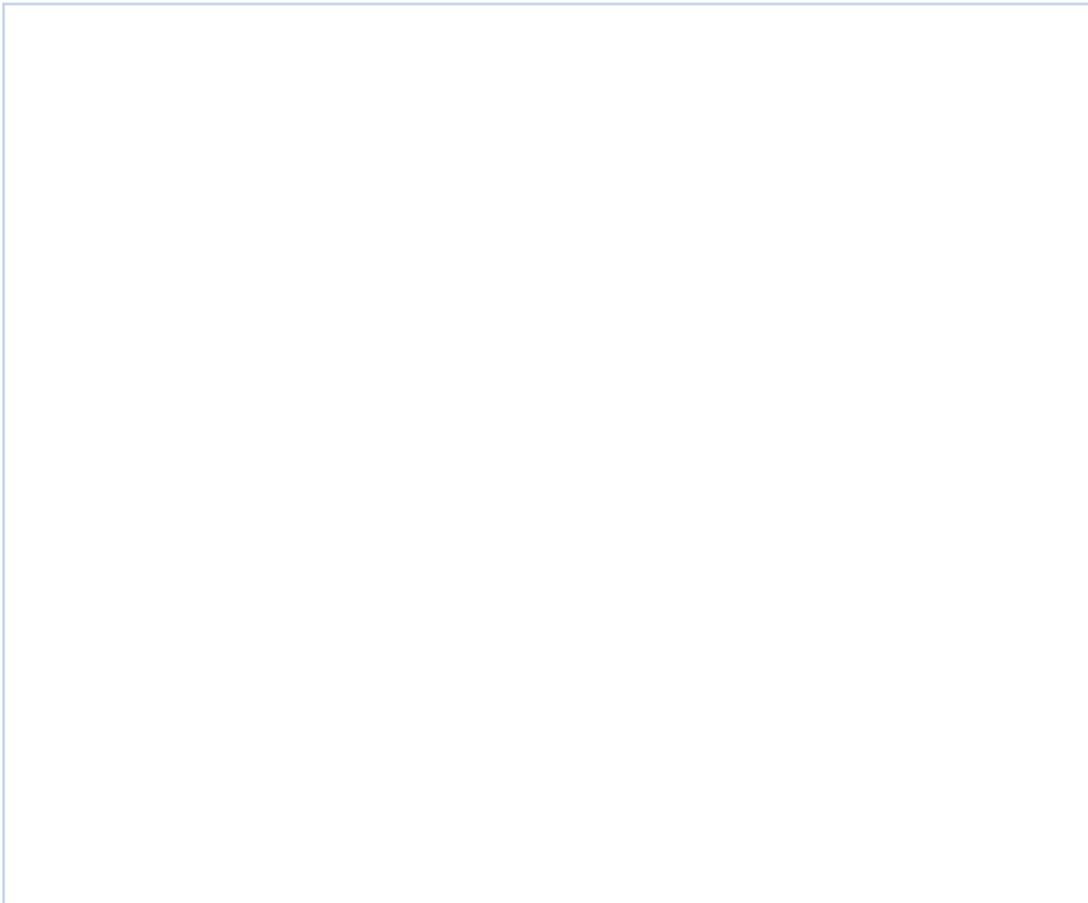
An external safety audit has identified a number of safety measures with which an organisation must immediately comply. These changes will impact the whole organisation. Each manager is asked to look at their budget and see where it can be modified. Your budget includes costs for staffing, equipment maintenance, new personal protection equipment (goggles and gloves), new computers, training and promotional activities.

- a) Explain what you discuss with the manager.

b) Explain how you communicate and discuss this with your team.



c) List some contingencies you consider to enable the safety measures to be implemented.



- d) What skills do you need to manage this part of budgeting successfully? For each skill you identify, briefly explain why you need it.

2. Present a draft budget that a finance manager prepared for a team using as much detail as possible, ensuring it is clear, accurate and easy to follow.
- a) Describe a scenario in which you identified some issues with the draft budget and called a team meeting.

- b) Explain how you negotiated any changes in response to the issues identified and with whom you negotiated.

- c) Describe some of the contingencies you suggested so the situation doesn't happen again.

Topic 2

Implement financial management approaches

Team members need to have the relevant information from budgets so they can perform their duties appropriately and make informed decisions. Work teams cannot work in isolation and must be supported with the appropriate resources and systems to achieve the desired objectives. They may need further training to gain the knowledge and skills to perform their roles and manage the team's finances accordingly. Failure to provide the necessary support and tools for work teams may lead to inefficiencies and failure to achieve the best outcomes for the organisation.

In this topic you will learn how to:

- 2A Disseminate relevant details of the agreed budget/financial plans to team members
- 2B Ensure team members perform financial tasks competently
- 2C Use resources and systems to manage financial management processes

2A

Disseminate relevant details of the agreed budget/financial plans to team members

During the developmental phase all team members should be exposed to their team's draft budget and contribute to any negotiations or adjustments made. Once the budget has been prepared and approved by senior management, the team or cost centre manager should make sure all team members understand the details of the budget and how it impacts their day-to-day duties.

Along with the budget, it's a good idea to distribute a sheet defining terminology, especially if team members are new to the organisation or have little financial knowledge; for example, if a company is referring to targets for 'regional sales' and 'metropolitan sales', articulate what defines a 'region' and what defines 'metropolitan'.

Disseminate information

It is essential to hold a specific budget meeting at which all budget details can be explained. Team members may have specific financial accountabilities and responsibilities in their department or organisation, and need to be appropriately informed of the budgets and financial plans relevant to their responsibilities. They also need to see how their particular budget fits in with the organisation's overall financial planning.

You might also provide an organisational responsibilities and contacts list so that team members can direct inquiries to relevant personnel if they need to query something.

When preparing to disseminate budget information, consider how you pass on the information, in what format it is circulated and when it is done.

Information management systems can be quite complex and difficult to handle in terms of generating useful reports. In the article 10 principles of effective information management, James Robertson (managing director of Step Two Designs), presents a good overview of principles that can be adopted to improve life for the user of these systems at: www.steptwo.com.au/files/kmc_effectiveim.pdf.



Communication methods

The method of communication depends on the structure and nature of the organisation, the facilities available and the capabilities of the employees. The organisation's communications policy and procedures for disseminating budget and financial plans also needs to take into account the nature of the workforce. The communication should be appropriate to the audience and cater for people from nonEnglish speaking backgrounds or with hearing or vision impairment and their varying skills and knowledge.

Shift and part-time workers need to be considered so that they can attend sessions if appropriate. You must also consider isolated workers or people based overseas, and arrange for budget and financial information to be passed on to them in the most appropriate way; for example, teleconferencing, videoconferencing, information pack or newsletter.

There are many communication methods that may be used, as described here.

Formal meetings

Where the recipients are identified and presented with specific information relevant to their roles and responsibilities.

Group meetings/sessions

Where a specific focus is required and those attending have a common area or linked activities.

Written communication

Where the information is sent via written memorandum, letter or report.

Face-to-face presentations

Where an audience can be selected (this can include such technologies as videoconferencing and teleconferencing).

Electronic communication

Where emails are sent to individuals or groups, or documentation is made available on the intranet.

Timing and format

Budget plans and information should be disseminated in a timely fashion so that there is sufficient lead-time for the recipients to make adjustments, if necessary, to the way they and their teams operate. People should have sufficient time to study the plans and note whether any points they had brought up in the developmental phase have been addressed.

The format for presenting the budget may vary depending on the information being delivered; for example, the information may be presented verbally as well as in written, numerical (spreadsheet or tables) or graphical form.

The format may also vary depending on the level of budget information being disseminated and the nature of the recipients as shown below.

Senior management

Senior management of a medium to large organisation might provide information to employees in a total staff presentation using a graphical overview of expected income and expenditure for the next year against projections based on historical data, plus any indications of impacts of potential global economic changes or other scenarios.

Team manager

A team manager may use an electronic presentation and provide a hard copy of the budget at a team meeting.

Example: disseminate a budget throughout an organisation

Ingrid is the CEO of a large clothing company that sells their products to a wide range of retail outlets, domestically and internationally. The CFO, Graham, is responsible for budget development and the production of a draft organisational budget based on draft budgets submitted from each of the cost centres. On Graham's recommendation, Ingrid approves the draft organisational budget.

Ingrid then explains to all cost centre managers the emphasis that has been placed on the various strategic objectives of the organisations, and how this has been incorporated into the analysis and approval process of the draft budgets. Graham presents the details of the organisational budget to the cost centre managers at the same meeting.

A further series of meetings are held with cost centre managers and their budget managers over the next two days; any work teams that have been involved in budget preparations are also briefed by Graham and the relevant cost centre managers.

The following week each cost centre manager disseminates the agreed and approved budgets to their work teams.

Ingrid and Graham publish a statement via email to all staff and on the intranet, as well as in print for noticeboards, so all staff are aware of the organisation's budget position and broad plans for the forthcoming year.

Practice task 5

Explain why it is essential that meetings are held to specifically explain the budget to team members.

2B

Ensure team members perform financial tasks competently

Once the budget has been explained to your work team, you need to make sure that everyone understands what they have to do to ensure their team meets the financial expectations. It is your duty to provide support, advice and guidance for staff members to ensure the budget is implemented successfully. There are two aspects to this, which are to:

- ensure roles and responsibilities are understood
- provide appropriate support to ensure staff carry out their financial management duties competently.

Manage finances

There is a wide range of responsibilities involved in the role of managing finances. Each task or function to be performed should have an appropriately documented procedure that can be followed. If any members of your team are responsible for these tasks, make sure they understand what they have to do, the resources they need, who they report to and who to refer to if they have any difficulties. The following shows the range of the tasks involved in the role of managing finances and the procedural inclusions of each task or role.

Financial operations

Ensuring security, accuracy and currency of financial operations

Understand and apply procedures for:

- internal control; for example, secure access to financial data and systems; passwords
- authorisations
- financial delegation
- auditing methods
- reporting requirements and reviews.

Invoicing

Invoicing clients, customers and consumers

Understand and apply procedures connected with:

- periods for invoicing; for example, weekly, monthly
- payment period
- discount rates if applicable for certain types of customers
- method of distribution; for example, electronic versus post.

continued ...

... continued

Record-keeping systems

Maintaining journals, ledgers and other record-keeping systems

- Understand and apply codes for cost centre and accounts.
- Understand levels of authority for financial record keeping, including approval requirements.
- Maintain daily financial records by entering transactions into relevant journals; for example, cash payments, cash receipts, purchases and purchase returns and allowances.
- Maintain the general ledger, including preparing a trial balance.

Taxation requirements

Maintaining financial records and processes to comply with taxation requirements

Understand the requirements for:

- goods and services tax (GST) including calculating, collecting, paying and reconciling payments
- personal income tax deductions from payroll
- income tax for businesses
- fringe benefits tax (FBT)
- pay as you go (PAYG) tax
- stamp duty
- payroll tax.

Wage/salary payments

Paying wages and salaries and keeping records

Follow procedures for:

- operating the payroll systems
- calculating gross pay
- calculating deductions; for example, PAYG Withholding
- determining net pay
- transferring funds to nominated accounts
- paying of superannuation contributions
- record-keeping requirements.

Petty cash system

Maintaining petty cash system

- Understand the petty cash system and required documentation and vouchers, including level of cash float and allowed expenditure.
- Maintain security and access to petty cash funds.
- Process reimbursements.
- Balance and reconcile petty cash fund.

The accounting process

The organisation's accounting process consists of the steps required to record all of the transactions that take place, and to organise and collate this information before finally producing financial reports that are analysed and used in decision making.

The accounting process is made up of the following sequence.

Transactions

Transactions are the financial or economic exchanges between the organisation and other parties. Each transaction leads to the creation of source documents.

Journals

Every transaction is recorded in a journal. Specialised journals can be used to record information on similar transactions (for example, cash receipts journal, purchases journal).

General ledger

The information entered into the journals is posted to the general ledger. The organisation has a separate general ledger account for each asset, liability, owner's equity, revenue and expense item. This account records increases and decreases in each item's balance. The general ledger is the complete set of all of these accounts.

Trial balance

In double-entry accounting, all transactions must have an equal dollar amount of debits and credits recorded in the general ledger accounts. The trial balance is a statement that lists all of the accounts in the general ledger and their debit or credit balances, to ensure that the overall general ledger is in balance – debits equal all credit balances.

Balance-day adjustments

The balances in the general ledger accounts must be adjusted at the end of the accounting period before final reports can be prepared. These are called balance-day adjustments.

Accounting reports

The accounting reports are the end product of the accounting process and are generated from the information collected during the accounting period and recorded in the journals and general ledger accounts. There are many reports that can be prepared including income statements and a statement of financial position.

The chart of accounts

The chart of accounts coding classifies all of the financial transactions of the organisation as affecting one of two categories within the accounting records of the business:

- Balance sheet items – assets and liabilities
- Profit and loss items – revenues (sales) and expenses

From this broad classification, coding then seeks to classify every financial transaction into the organisation's chart of accounts. The chart of accounts is the framework of all of the accounts in the organisation's accounting system. Each account in the chart of accounts is used to record a particular type of financial transaction and is given a unique account number (code).

Similar accounts are grouped together by giving them sequential account codes or numbers. There is a chart of accounts that discloses the five account classifications used in the organisation's accounting system.

The five account classifications of the chart of accounts:

- Assets
- Liabilities
- Owner's equity
- Revenues
- Expenses

The concept of accrual accounting

The organisation's financial performance (profits) can be measured on either a cash or accrual basis. Here is a short description of cash and accrual accounting.

Cash basis

Under the cash basis of accounting, the organisation's revenues are recorded in the accounting period when cash is received and expenses are recorded when cash is paid. Cash in this sense refers to the act of payment, not the tender, and can include credit card, cheque or barter as well as cash.

Accrual basis

Under the accrual basis of accounting, revenues are recorded when they are earned (that is, when the business sells goods or performs services) and expenses are recorded when they are incurred in earning that revenue (that is, when goods and services are consumed). Thus, the concept of receiving or paying cash is not relevant in determining profit.



Accrual accounting advantages

Most organisations use the accrual basis of accounting because this most accurately determines the organisation's performance when there are transactions that overlap from one accounting period to the next. For example, cash received from a customer may relate to services performed in the previous accounting period. Under the cash basis, this would be recorded as revenue when the cash is received, even though the services for the customer were performed in the previous period. Recording this as revenue for the current period is misleading because the business expended its energy and resources in earning the revenue during the last period, so it makes sense to record this as revenue for the previous period under the accrual basis.

Likewise, an organisation may prepay a rental lease for an entire year. If profit is to be calculated halfway through the year, then only half of the rent has been consumed with the other half relating to the next accounting period. Under the accrual basis, only the rent consumed is included as an expense. However, under the cash basis, the entire rental amount paid at the start of the year is treated as an expense for the previous accounting period, even though half of this payment relates to the future. This results in a misleading and mismatched profit calculation.



The matching principle

One of the core principles of accounting is the matching principle, which states that all revenues generated in an accounting period should be matched with the expenses incurred in generating them, in order to determine the organisation's performance (profit).

Therefore, the accrual basis of accounting facilitates the matching principle by recording revenues and expenses when they are earned or incurred, rather than recording them when cash is received or paid.

During an accounting period, there may be many transactions that overlap from one period to the next. For example, some expenses may be paid in advance while others may have been incurred in the previous period but payment is not due until the next period. Similarly, revenue may have been earned in the previous period but payment is not expected until the next period. How should transactions such as these be recorded?

Accrual accounting ensures the matching principle is maintained by only including revenues and expenses that have been earned and incurred in the accounting period in question when determining profit. This concept leads to the need for the organisation to make balance-day adjustments.

Balance-day adjustments

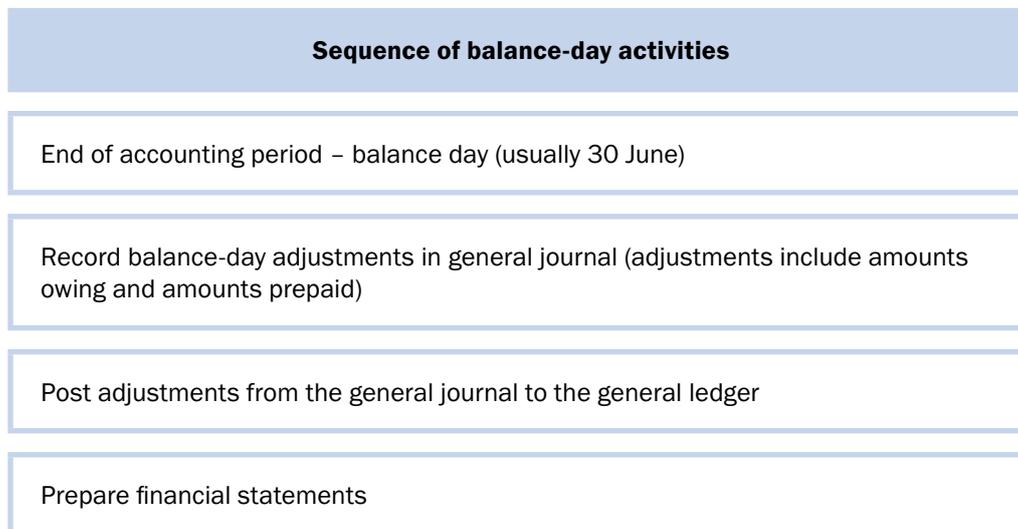
Balance day refers to the last day of the accounting period; for example, 30 June or 31 December. The occurrence of balance day may mean that some transactions overlap from one accounting period to the next. This means that some adjustments to the balances in the general ledger accounts need to be made on balance day to ensure that all revenues and expenses recorded relate to the accounting period in question and not another period in the future. Only once these balance-day adjustments are made can the organisation take the next step in the accounting process and begin to accurately prepare its accounting reports.

The balance-day adjustments relate to:

- depreciation
- sale of non-current assets
- prepaid expenses
- accrued expenses
- prepaid revenue
- accrued revenue
- stocks of supplies and materials.

Understand balance-day activities

The activities that must be performed at balance-day are illustrated below.



Calculate profit or loss

To calculate profit or loss, the revenue earned by the business is matched against the expenses incurred by the business. If the revenue exceeds the expenses, the business has made a profit; if the expenses are greater, a loss has been incurred.

It is the accountant's objective to measure, as accurately as possible, the profit or loss earned by the business during an accounting period. In order to do this you have to match, as closely as possible, the revenue earned during the period with the associated expenses of that period.

Accrual accounting is the accounting practice used by most businesses. Accrual accounting is based on the matching principle; that is, it relies on the accurate matching of the revenue earned in a period with the expenses incurred to generate that revenue.

Revenue is earned when the transaction takes place, rather than when the cash is collected. Expenses are recognised in the period in which they are incurred, not when they are actually paid. Therefore, profit is calculated as the revenue recognised in the period less the expenses incurred in earning that revenue. Matching revenue and expenses in this way provides a more accurate account of the operating performance of a business than the alternative – the cash basis of accounting.

Adjustments

Up to the trial balance stage, it is assumed that the expenses paid during an accounting period correspond exactly to the amounts due to be paid during that period. For example, if the profit is being calculated for the year ended 30 June 2016, it is assumed that the rent paid and recorded in the rent account is exactly the amount that was due for that period. However, in reality it is likely that some of the rent will have been paid in advance for the next period. Other expenses, such as wages and electricity, may have been incurred but may not be paid until after the end of the current accounting period.



Accountants assume that a business is a profitable concern. In the absence of clear evidence to the contrary, the business will continue operating beyond the end of the accounting period. Because of this, certain transactions of the business may overlap accounting periods.

Therefore, revenue and expenses received or paid within a period may not necessarily relate to that particular accounting period. All or part may apply to the accounting period before, or after, the period in which it was actually received or paid.

While accrual accounting provides an accurate picture of profitability, the accuracy depends on certain adjustments being made prior to the preparation of the financial statements. These adjustments are referred to as balance-day adjustments.

Balance-day adjustments

The balance day adjustments which are required to be performed are described below.

Accrued expenses

Accrued expenses are those that have been incurred in the current accounting period but not paid by the end of the accounting period. For example, salaries and wages are an expense often incurred but not paid as of balance day, because the end of the accounting period may fall midway through a pay period.

Prepaid expenses

Prepaid expenses are expenses that have been paid in the current accounting period but relate to the next financial year. This results in an overstatement of expenses for the current period as the payment of the expenses will be recorded in the current period. For example, insurance is an expense that is often paid in advance.

Accrued revenue

Accrued revenue is revenue that has been earned in the current accounting period but not received as at the end of the accounting period. Examples of accrued revenue include commission revenue, dividends revenue and interest revenue on investments earned and not received or recorded as owing to the business.

Prepaid revenue

Prepaid revenue is revenue that has been received in the current accounting period but not yet been earned as at the end of the accounting period. For example, rent earned on a rental property may have been received in advance for the following period.

Where revenue has been received in advance, the revenue account must be reduced to ensure the account only includes income for the current period and the amount received in advance is recorded as a liability; that is, owing to the person/organisation that paid in advance.

Depreciation

Depreciation is the allocation of the capital cost of an asset over its estimated useful life. The two most commonly used ways of calculating depreciation are the straight-line and reducing-balance methods. As depreciation is normally recorded at balance day, it is regarded as a balance-day adjustment, part of the process of ensuring that all expenses incurred for the current accounting period are recorded, and that the assets are reported at their written-down value.

Bad debts

An organisation may decide to write off an amount that is owed by a debtor if it is deemed to be irrecoverable due to bankruptcy or other reasons. The writing off of a bad debt is an expense to the business and is only done when all other avenues of debt collection have been exhausted, with no chance of recovering the money from the debtor.

It is standard practice to estimate the value of debtors that are unlikely to be collected in the future from credit sales made in the current accounting period. This estimate is referred to as 'doubtful debts' and is recorded as an expense in the current accounting period to be matched against the revenue earned from the sale in that period.

An age analysis classifies debtors according to how long their accounts have been outstanding. The classifications are usually broken down into 0 to 30 days, 31 to 60 days, 61 to 90 days and 91 days and over.

Trading stock

Trading stock, sometimes referred to as inventory, consists of the goods an organisation buys from suppliers and sells to its customers. On balance day, the organisation performs a manual stocktake to ascertain the value of the trading stock that is on hand and available for sale in the next accounting period.

Purchases of trading goods are recorded in the purchases expense account. In accordance with the accrual accounting concept, purchases are recognised in the period in which they are incurred. At the end of the accounting period, the organisation may still have some of these trading goods in stock. In other words, the organisation now has an unused purchases expense for this accounting period.

Those goods still in stock will be sold in the next accounting period so the expense should be identified and recorded in the next accounting period.

Provision for leave

At the end of the accounting period (balance day), you must calculate the annual and long service leave entitlements accrued by employees so you can record the annual leave expense that has been incurred to date. This must be done to ensure the expense is recorded in the period in which it is incurred in accordance with the accrual accounting principle. An adjustment is necessary to record the expense in the leave expense account and to recognise that the organisation has a liability for the unpaid leave earned as of balance day.

Assets

Assets are generally defined as physical or non-physical items that:

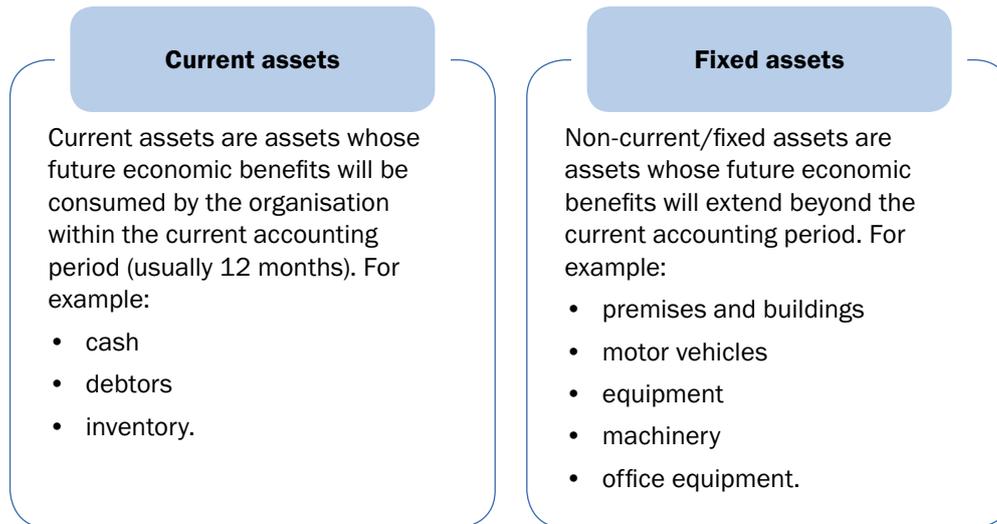
- will provide future economic benefits to the organisation by generating revenue and/or through the disposal of the asset
- are controlled by the organisation; for example, through ownership of the asset
- arise due to a past transaction or event; for example, a purchase.

An asset register, also known as a register of property, plant and equipment, records all the details of the non-current/fixed assets of a business. A separate record is kept by the business for each individual fixed asset. The individual asset registers can be seen as a subsidiary ledger in much the same way as a debtors subsidiary ledger and a creditors subsidiary ledger.

An organisation records the details of all of its assets in an asset register.

Asset types

Assets are listed in the organisation's statement of financial position in order of liquidity, which is defined as the ability to turn the asset into cash. As such, assets are usually broken up into two categories as shown here.



Asset register

Non-current assets are classified into a further three categories:

- Tangible assets are also known as 'property, plant and equipment' or 'fixed assets'. They are physical assets. Examples of tangible (fixed) assets are land and buildings, plant and machinery, motor vehicles and office equipment.
- Intangible assets do not have a physical existence. Examples of intangible assets are goodwill, copyrights, trademarks and patents.
- Investments or financial assets are amounts that have been invested by the business into financial instruments or securities such as shares, debentures and bonds. These investments are for periods greater than 12 months.

All assets are recorded in an asset register. The records contained in an asset register can either be in the form of a card system or a computerised system.

The details recorded on the fixed asset register may include:

- a description of the asset
- an identification number
- the location of the asset
- supplier information
- annual depreciation and accumulated depreciation
- depreciation method and rate of depreciation
- estimated residual value
- estimated asset life
- total capital cost
- disposal of asset details
- repairs and maintenance
- other relevant information.

The capital cost of an asset

The total capital cost of an asset includes the purchase price of the asset plus any additional costs associated with preparing the asset for use in the business. Additional costs include:

- installation
- delivery
- modifications required by the business
- stamp duty
- customs duty.

The capital cost of an asset does not include any goods and services tax (GST) paid, as this is claimed back by the business from the Australian Taxation Office (ATO) as an input tax credit (if the business is registered for GST).

Recurring costs associated with an asset are also not included in the capital cost. Recurring costs are those costs associated with the ongoing use of an asset. These include annual insurance, registration, repairs and maintenance.



Depreciation

There are a number of methods a business may use to calculate depreciation of an asset. The two most commonly used methods are described below.

Straight-line depreciation

Also known as prime-cost depreciation or on-cost depreciation, this method allocates the total capital cost of the asset evenly over the asset's estimated useful life, meaning that the annual depreciation is the same amount each year.

Reducing-balance depreciation

Reducing-balance depreciation is also known as written-down-value depreciation or diminishing-value depreciation. This method calculates depreciation based on the written-down value of the asset each year.

The written-down value is equal to the cost price of the asset less the accumulated depreciation charged against the asset. The written-down value can also be referred to as the book value or the carrying cost.

The effect of using the reducing-balance depreciation method is higher annual depreciation in the early years of the asset's estimated useful life than in the later years.

Disposal of an asset

When an asset is sold, the asset register card must be updated to show the details of the disposal (date, purchaser, price) and the profit or loss that resulted from the disposal of the asset.

When an asset is sold:

- record the details of the disposal in the disposal section of the asset register card
- calculate the amount of depreciation on the asset to the disposal date and record it on the asset register card
- determine whether a profit or loss has resulted from the disposal of the asset.

The disposal value, excluding GST, is recorded on the main section of the asset register card. If the disposal value is greater than the asset's written-down value, a profit on disposal will be recorded. If the disposal value is less than the asset's written-down value, a loss on disposal will be recorded.

Finalise general ledger accounts

At the end of the accounting period, once all the balance-day adjustments have been posted, it is necessary to finalise the accounts in the general ledger and produce financial reports.

In order to produce these reports, the balances in the revenue and expense accounts in the general ledger need to be transferred or closed to profit determination accounts in the general ledger, thereby closing off the revenue and expenses to a nil balance.

These profit determination accounts, known as the trading account and the profit and loss account, are temporary clearing accounts that are set up and used for the purpose of determining profits/losses.

Finally, the owner's equity account, the capital account, is finalised by transferring the net profit or loss from the profit and loss account together with the amount taken by the owner as drawings.



The trading account

The trading account is used by organisations that buy and sell goods or trading organisations. The purpose of the trading account is to determine the organisation's gross profit or gross loss. The trading result is calculated by deducting the cost of purchasing the goods and getting them ready for sale, from the revenue earned from selling the goods, that is:

$$\text{Trading revenue} - \text{Cost of goods sold} = \text{Gross profit/loss}$$

The gross profit must be sufficient to cover the other operating costs of the organisation to return a net profit. The information in the trading account is used for the preparation of the income (profit and loss) statement.

The process used by other types of businesses to close their accounts is described here.

A business that buys stock, marks up and on-sells (trading)

- Enters general journal entries for closing revenue, expense and stock account balances
- Posts revenue, expense and stock account balances to the trading account and profit and loss accounts
- Determines gross and net profits
- Closes accounts to the capital account

A business providing a service

- Enters general journal entries for closing revenue, expense and supplies account balances
- Posts revenue, expense and supplies account balances to the cost of supplies account and profit and loss accounts
- Determines cost of supplies and net profits
- Closes accounts to the capital account

Stock adjustments

Before the revenue and expense accounts can be transferred into the trading account, the opening balance of the stock account needs to be transferred.

The opening balance of the stock account represents the stock that was not sold in the last accounting period and was available to be sold in this accounting period. By transferring the opening stock balance into the trading account you are following the accrual accounting concept and recognising that the cost of this stock is an expense for this accounting period.

The recording of closing stock recognises the unused purchases expense from this accounting period. Although the closing stock adjustment is a balance-day adjustment, it is more practical to enter the adjustment as part of the closing procedure.

Gross profit or loss

After all the trading revenue and cost of goods sold expense account balances have been transferred to the trading account, the remaining balance represents either:

- a gross profit (if a credit balance)
- a gross loss (if a debit balance).

A gross profit results where the trading revenue earned is greater than the total of all the cost of goods sold expenses – total credits exceeds total debits.

A gross loss results where the total of the cost of goods sold expenses is greater than the trading revenue earned – total debits exceeds total credits.

Because the trading account is a temporary or clearing account, the balance remaining in the account (gross profit/loss) must be closed to a nil balance. To do this, the gross profit/loss is transferred to another temporary or clearing account called profit and loss account to determine the overall net profit or loss for the accounting period.

The profit and loss account

The profit and loss account is a temporary or clearing account that is used to determine the organisation's net profit/loss. The net profit/loss is calculated by adding any non-trading revenue earned in this accounting period to the gross profit, then deducting all other operating expenses incurred during this accounting period; that is:

$$\text{Gross profit} + \text{Non-trading revenue} - \text{Other operating expenses} = \text{Net profit/loss}$$

If an organisation has recorded a gross loss, the equation would be:

$$\text{Gross loss} + \text{Other operating expenses} - \text{Non-trading revenue} = \text{Net profit/loss}$$

Determine owner's equity

The final stage of the closing procedure is to identify the closing balance at the end of this accounting period for the capital account/s. The final account that must be closed and transferred is the drawings account.

Drawings represents the value of the total withdrawals made by the owner during this accounting period and must be deducted from the overall capital balance.

Prepare end-of-period financial reports

At the end of the year (calendar or financial) after all closing procedures have been finalised, it is necessary to prepare the end-of-period financial reports.

The two main reports prepared for a sole trader business are the income (profit and loss) statement, which shows the net profit (loss) and the statement of financial position, which discloses the balances of asset, liability and the owner's equity accounts.

The income (profit and loss) statement, commonly referred to as the profit and loss statement, reports on the revenues and expenses for the year and has the following features.

Title

The title of the statement must show the name of the organisation and the accounting period for which the statement is being prepared; for example, for the year ending or for the months ending.

Trading section

All revenues and expenses shown in the general ledger trading account are reported in the trading section of the statement to show the organisation's gross profit or loss.

Profit and loss section

All revenues and expenses shown in the general ledger profit and loss account are included in the statement to show the organisation's net profit or loss.

The statement of financial position (balance sheet)

The statement of financial position is a listing of the organisation's assets, liabilities and owner's equity balances and is presented in a format that is similar to the accounting equation:

$$\text{Owner's equity} = \text{assets} - \text{liabilities}$$

The statement of financial position has the following features.

| |
|--|
| Title |
| The title of the statement must show the name of the organisation and the date at which the statement has been prepared; for example, as at 30 June 2016. The words 'as at' must be used, as the statement of financial position shows the account balances at a particular date, unlike an income statement, which shows the profit (loss) over a period of time. |
| Owner's equity |
| The full details of the amounts owing to and taken by the owner must be reported, hence the opening balance, drawings and net profit/loss are listed as shown in the general ledger capital account. |
| Working capital |
| Working capital is the term used to refer to the organisation's liquidity. This is the ability of the organisation to meet its current liabilities from current assets available. The balances of all the current asset and current liability general ledger accounts are listed. The difference between the total of current assets and current liabilities represents working capital. |
| Current assets |
| Current assets are assets that are either cash or convertible to cash within the ensuing 12 months. Examples of current assets include cash at bank, input tax credits, debtors, stock, prepaid expenses, accrued revenue. Provision for doubtful debts is also included, as it is a negative current asset that is deducted from debtors to determine a net debtors' balance. |
| Current liabilities |
| Current liabilities are liabilities that are expected to be repaid within the ensuing 12 months. Examples of current liabilities include creditors, GST payable, accrued expenses, prepaid revenues and provision for annual leave. |

continued ...

... continued

| |
|--|
| Net assets |
| Net assets represent the final balance of all assets less all liabilities and should equal the owner's equity balance. In the narrative form of the statement of financial position, net assets is determined by adding non-current assets to the working capital balance and then deducting deferred liabilities. |
| Non-current assets |
| Non-current assets are assets that are held for longer than 12 months and are used by the business for generating revenue in the future. Examples of non-current assets include land, buildings and motor vehicles. Accumulated depreciation of assets is also included as a negative non-current asset to be deducted from the capital cost of the assets to determine written-down values. |
| Deferred (non-current) liabilities |
| Deferred (non-current) liabilities are liabilities that are unlikely to be repaid within the next 12 months. Examples of deferred liabilities include mortgages on land and buildings, loans (due in over a year) and provision for long service leave. |

Financial recording to meet statutory requirements

Australian organisations have statutory requirements affecting the manner and frequency of their reporting. To ensure statutory requirements are met, the organisation needs to understand what these requirements are, the regulatory bodies to whom they must be submitted; the formats to be used when supplying the information and the time lines for their completion and submission. An important part of your role is to ensure that all information in both source and submitted documents is accurate, relevant and reliable.

Keep up to date with statutory requirements

It is important that you are aware of the records that are required to meet the statutory requirements that your organisation must comply with. You need to continually update your knowledge to keep abreast of these changing requirements.

Many of these requirements are continually undergoing legislative changes and it is the responsibility of organisations to ensure that they are up to date with the current legislation.

Part of your role may be to brief senior management on the latest changes to ensure compliance and obtain approval for action. If you work in a small organisation, you might liaise with a certified public accountant whose role it is to ensure the organisation is kept up to date with changing requirements. Australian requirements are listed here.

Regulatory requirements for organisations in Australia

- Reporting of GST and other taxation-related issues on the business activity statement
- Administering and reporting the superannuation guarantee levy
- Complying with the capital gains tax and fringe benefits tax regulations
- Compliance with the *Income Tax Assessment Act 1997* (Cth) (for organisations registered as companies)
- Compliance with the Corporations Law
- Compliance with the Australian Accounting Standards

The main regulatory bodies

The main bodies regulating the reporting of the financial affairs of an organisation in the public arena are outlined here.

ASIC

Australian Securities and Investments Commission (ASIC)

ASIC is the chief regulatory agency of all incorporated entities (public and private) and fund managers within Australia. ASIC has responsibility for the administration and enforcement of the *Corporations Act 2001* (Cth), *Australian Securities and Investments Commission Act 2007* (Cth), *Insurance Contracts Act 1984* (Cth), *Superannuation (Resolution of Complaints) Act 1993* (Cth), *Superannuation Industry (Supervision) Act 1993* (Cth), *Retirement Savings Account Act 1997* (Cth), *Life Insurance Act 1995* (Cth) and the *Medical Indemnity (Prudential Supervision and Product Standards) Act 2003* (Cth). ASIC is responsible for protecting investors and consumers in the Australian financial system.

Incorporated entities can take the form of companies, incorporated associations (including not-for-profit entities) and trusts. All entities covered by ASIC must submit an annual return by January each year noting changes to address, incorporation and directors' details. All incorporated bodies must also submit a copy of their annual accounts.

For public companies, those accounts must be presented in accordance with the Australian Accounting Standards and must be audited. In addition, public companies must also disclose a summarised half-yearly result, showing income, expenditure and profit, balance sheet and cashflow.

For private companies the requirements are not as stringent. Private companies can report their financial affairs with less formality and disclosure and their accounts do not need to be audited.

ATO**Australian Taxation Office (ATO)**

The ATO is the federal government agency for collection of all income- and asset-based taxes, as well as sales-based taxes such as GST.

Reporting of income and expenditure for GST purposes is required by organisations 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 the financial year.

Companies are also required to pay their income tax to the ATO regularly throughout the year and prepare an income tax return at the end of each year in accordance with the requirements of the *Income Tax Assessment Act 1997* (Cth).

ASX**Australian Stock Exchange (ASX)**

The ASX requires ongoing disclosure by public companies that choose to list on the stock exchange. Listed companies must report to the ASX any significant business issue that may reasonably have an impact on company share values or investors' decision making.

Copies of an organisation's audited annual reports and half-yearly reports submitted to ASIC must also be lodged with the ASX. The ASX's additional requirement is that a preliminary final report must be lodged in the same format as ASIC's half-yearly report within 75 days of the end of the accounting period. Final annual accounts must be supplied within 90 days of the end of the 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 must also lodge quarterly cashflow reports and summaries of mining exploration activities during the period.

APRA

Australian Prudential Regulation Authority (APRA)

APRA is the federal government agency responsible for regulating the financial health of Australia's banks, life and general insurers, building societies, credit unions, friendly societies and superannuation funds.

APRA's purpose is to ensure that the financial services industry is operating prudently and in the best interests of investors and those who are insured. If another non-financial services company owns these businesses, the parent company must also comply with the normal ASIC reporting requirements.

Financial services business must report to APRA using a prescribed format known as 'margin on services'. This measure aims to ensure that a sufficient positive margin is made on the financial services provided to be able to cover the likely level of long-term payouts required under the terms of the insurance and investment policies written.

Full disclosure of profit and loss (including detailed disclosure of income and expenditure), balance sheet, cashflow and notes to the accounts is required in this format annually, again with a summarised form to be produced half-yearly. Quarterly statistical and financial reporting on sales of particular products and the stability of assets and liabilities is also required.

Record individual financial transactions

The statutory requirements described refer to the final (in some cases annual) accounts the organisation prepares. While it is generally only the final reports (income statement, balance sheet and cashflow statement) that are reviewed by external regulatory parties, the source data must be in an appropriate form and level of detail to provide accurate information.

An organisation's financial reports represent the hundreds and thousands of financial transactions it engages in with other parties. The processing and recording of these transactions, and their subsequent source documents, form the basis of the financial records and reports supplied to the regulatory bodies.



Audit

The process of auditing accounts ensures that source data is accurately recorded for each and every financial transaction. Auditing also shows that the organisation's accounts have been prepared in accordance with statutory requirements.

The difference between primary and secondary source data is explained here.

Primary source data

The primary source data for an organisation's financial transactions may be either hard copy or electronic and generally includes:

- purchase requisitions
- purchase orders
- delivery dockets
- cash register rolls
- receipts
- credit card vouchers
- credit card merchant summary
- cheques received listing
- bank deposit forms
- statements of account
- cheque requisitions
- cheques/cheque butts
- remittance advice
- invoices (GST-free)
- tax invoices
- adjustment notes issued and received
- petty cash vouchers.

Secondary source data

Secondary records of income and expenditure include:

- journals and ledgers in which purchases and income items are recorded
- stock on hand records that measure movements of stock in and out as a result of sales and restocking
- bank statements.

The reporting/lodgment period

A crucial part of statutory financial reporting is knowing the reporting or lodgment dates by which statutory reports must be submitted. You should know the submission dates of all financial reports, whether they are statutory guidelines or deadlines the organisation sets for itself in preparing reports. Refer to your organisation's financial calendar to ensure you provide the right information in the right format, for the correct period and by the due date.

The reporting period covered will vary according to the particular regulatory body. All regulators clearly outline the requirements, period covered and due dates to those organisations that need to comply. For example, the ATO issues blank or electronic copies of the Business Activity Statement forms with a covering letter specifying the month or quarter to be covered.

Other regulators outline the required formats, frequency of reporting and due dates in an initial bulletin and simply expect compliance thereafter. Regulators are also responsible for communicating any changes to requirements and the dates from which they take effect.

Calculate taxation liabilities

An important part of the organisation meeting its statutory reporting requirements is the calculation and submission of taxation liability. It may be your responsibility to gather data that is used by the regulatory bodies to calculate your organisation's taxation liabilities.



The Australian federal government, through the Australian Accounting Standards Board, is responsible for developing and issuing accounting standards that comply with the accounting standards used internationally.

These accounting standards must be followed by all Australian reporting organisations. To keep abreast of the development of these accounting standards towards international compliance, refer to the website of the Australian Accounting Standards Board at: www.aasb.gov.au

Accounting standards

There are two accounting standards that are directly relevant to gathering revenue data for statutory recording and reporting. These are described below.

AASB 101 – Presentation of financial statements

AASB 101 requires accrual accounting concepts to be adopted and that all information (data), when recorded in source documents and carried through to the accounting records, be:

- relevant, in terms of the size and nature of the transaction
- reliable, in that it faithfully conveys the nature of the underlying transactions
- able to show the economic impact on the business of the transaction, i.e. increasing sales, increasing expense levels, increasing asset or liability levels within the organisation; the recording must be at an adequate level of detail
- treated consistently over time so that information is understandable and comparable over different aspects of the business and over different periods of time.

AASB 118 – Revenue

AASB 118 stipulates that the treatment of income (termed in the standard as revenue) must have these same characteristics, but also prescribes those items that can generally be treated as revenue.

Taxable revenue

It is important that you are aware of the type of revenue that is taxable that may not be part of your organisation's everyday operations but must be included in the profit and loss statement. For example, your organisation may sell some office equipment during the year.

The following information sets out different streams of revenue.

Streams of income revenue

1**Proceeds from the sale of goods**

This occurs mainly in manufacturing, wholesale or retailing operations where goods are either produced and sold or purchased and sold on to other parties, usually at a profit.

2**Fees from the provision of services**

Income from services is generally fee based, such as professional legal services, or plumbing services. It is just as much income as revenue from physical goods and should be recorded in the accounts as such.

3**Rental or lease income from the use of assets by others**

Usually these assets are bought with the specific purpose of hiring them to other parties. Examples range from a simple trailer for rent through to motor vehicles, heavy manufacturing equipment and even commercial premises. Care needs to be taken in understanding the nature of the contract in place, as this will affect how income is recorded.

4**Disposal of working assets for a profit**

Gains on the sale of working assets used within a business are to be treated as income and shown as a gain on sale of assets within the profit and loss statement.

5**Income from the use of cash assets**

For example, income from loans.

6**Interest**

Interest earned on the lending of money to other parties is treated as income within the accounts, as is interest received on deposits with financial institutions.

7

Revenue received from royalties

This is treated as income and should be shown separately as royalty income within the profit and loss account. Royalty income is generally the proportionate share from each sale of an item paid to its original creator. Common examples of royalty income are proceeds from the sales of published books, music and other created works that can be copied and sold under licence.

8

Dividend income received as a return from the ownership of shares in another business

All dividends must be shown as income; however, it is important to know whether the income comes to the investor fully franked, partially franked or unfranked.

Other taxation liabilities

In addition to knowledge about treatment of conventional income and expenses and taxation rates attaching to profits, you should also be aware of other specific forms of taxation, such as GST liability and payroll tax. These must be calculated and provided for on a regular basis as part of an organisation's statutory responsibilities.

It may be your task to create the source documents and accounting entries for these items. If you are the accounts officer in a small business, you may have to look after the whole spectrum of tax liabilities. However, if yours is a large organisation and you work in a specialised corporate department, such as the payroll department, you may only have partial responsibility for some aspects of payroll tax calculation and nothing else.

Regardless of the size of the organisation, it will still be a requirement to provide accurate information for the following taxes and levies.

Goods and Services Tax (GST)

Most organisations with an annual turnover of \$50,000 or more are required to register for GST. Not-for-profit organisations must register for GST if their annual turnover exceeds \$100,000. Annual turnover is the total revenue from sales and services provided for the year, excluding GST.

Organisations with an annual turnover below the threshold are also able to register for GST, although it is not compulsory.

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

- accounting for GST on all taxable sales and supplies (one-eleventh of the total sale price)
- issuing tax invoices
- accounting for and claiming GST paid (Input Tax Credits) on all taxable purchases (one-eleventh of the total purchase price)
- completing and lodging a business activity statement each tax period and remitting any net GST payable to the ATO. The relevant time frame varies depending on the frequency of reporting, for example: monthly or quarterly reporting.

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

PAYG withholding requires that organisations (making payments classified as 'withholding') be responsible for deducting tax from the payment to the payee and remitting the amounts withheld to the ATO either weekly, monthly or quarterly.

The frequency of the remittance is determined by the size of the paying organisation. Disclosure of the total amounts withheld is shown on the organisation's business activity statement.

The list of withholding payments is quite extensive and includes:

- wages and salary payments to employees
- commissions, bonuses and allowances
- directors' fees
- eligible termination payments
- unused leave paid on termination
- social security payments
- compensation, sickness and accident payments
- withholding of 46.5 per cent on payment of supplies where a supplier does not quote a valid ABN.

Payers of withholding payments must register for PAYG withholding. To register for PAYG withholding, organisations must hold a valid ABN.

continued ...

... continued

PAYG instalments

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

The ATO advises each organisation as to whether they are required to pay PAYG instalments and issues the organisation with a PAYG instalment tax rate. Payments are shown and remitted with the business activity statement.

At the end of the financial year, the organisation lodges an annual income tax return. Any PAYG instalments paid during the year are credited against the total tax liability calculated from the income tax assessment.

Fringe Benefits Tax (FBT)

Organisations that provide employees with payments in the form of non-cash benefits may be required to register for and remit FBT at the rate equal to the top prevailing marginal rate of personal taxation plus the Medicare levy. This is because the benefit is deemed to be made as a substitute for taxable income.

The applicable rate is currently 48.5 per cent. It should be noted that the tax year for FBT differs to the normal financial year and runs between 1 April and 31 March. Some benefits that are generally subject to fringe benefits tax include:

- Cars: a car fringe benefit arises when a car owned or leased by an employer is made available for the private use of the employee.
- Loans: a loan fringe benefit arises when an employer provides a loan to an employee either interest free or at an interest rate that is less than the statutory interest rate.
- Housing: a housing fringe benefit arises when an employer provides accommodation to an employee rent free or at a reduced rental and it is the employee's usual place of residence.
- Airline transport: an airline transport fringe benefit arises when an employer provides airline transport (for-non-work-related travel) to an employee for free or at a discounted rate.

Employers are required to calculate the amount of fringe benefits provided to employees during the fringe benefits year, calculate the amount of FBT payable, and complete a fringe benefits tax return form. Amounts are recorded as liabilities in the general ledger.

The timing of the payment of the fringe benefits tax is determined by the total amount that is payable and whether the employer has previously lodged a fringe benefits tax return.

Superannuation guarantee levy

All employers are required to contribute to a complying superannuation fund for all eligible employees (currently 9.5 per cent of gross ordinary income). This is known as the superannuation guarantee levy.

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. This is a significant incentive to make organisations put in place their own arrangements with complying superannuation funds.

continued ...

... continued

There are some categories of employees that are not eligible to have superannuation paid on their behalf. These include employees who are:

- paid less than \$450 per month
- aged over 70 years
- aged under 18 years and working less than 30 hours per week
- performing work of a domestic or private nature and working less than 30 hours per week.

Organisations are not required to register for the superannuation guarantee but must ensure all employees belong to a complying superannuation fund so payments can be remitted to their 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. Some of the most common types of payments included are:

- wages and salaries
- leave payments
- allowances
- bonuses and commissions
- superannuation guarantee levy
- fringe benefits
- directors' fees.

These are recorded in the payroll accounts. Some types of payments are generally not subject to the payroll tax calculation and include:

- payments to or on behalf of apprentices or registered trainees
- workers' compensation payments
- redundancy payments.

Each state and territory has its own specific exemptions. Be familiar with those that are applicable to your state/territory.

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

Submit statutory reports

Keeping to time lines is a crucial part of managing an organisation's statutory reporting requirements. Throughout the year there are important deadlines you have to meet to provide both internal and external parties with financial information. Some deadlines are for monthly items and returns (such as large company business activity statements), others for quarterly, half-yearly or annual items such as financial statements. Some deadlines involve lodgment of funds as well as information such as payment schedules.

For each type of statutory reporting requirement there is a deadline. For example, large companies (those with a turnover of more than \$20 million per annum) must lodge monthly business activity statement returns by the 28th of the following month. If turnover is less than \$20 million, the organisation can lodge its business activity statement monthly or quarterly. If turnover is expected to be less than \$75,000, the organisation can lodge its business activity statement monthly, quarterly or annually.

ASIC annual statements relate to the updating of address and directors' details and must be lodged by the anniversary of the organisation's date of incorporation.

ATO reporting deadlines

All organisations with a valid ABN are required to report activity on the applicable activity statements to the Australian Taxation Office as outlined below. All activity statements are due to be lodged and payments made by the 28th day following the end of the reporting period.

Monthly lodgment

Organisations are required to complete an activity statement and remit payment to the ATO every month if their activities include any of the following:

- The annual turnover exceeds \$20 million
- The organisation's income tax year ends on a date other than 30 June
- Annual PAYG withholding exceeds \$25,000 but is less than \$1 million

Where an organisation's annual PAYG withholding exceeds \$1 million there is a requirement that the amount withheld be remitted to the ATO weekly.

Quarterly lodgment

Organisations are required to complete an activity statement and remit payment to the ATO on a quarterly basis if their activities include any of the following:

- The annual turnover is less than \$20 million
- The annual PAYG withholding is less than \$25,000
- PAYG instalments is payable
- FBT is payable

Organisations that are required to report quarterly may choose to report on a monthly basis but must notify the ATO of their intentions.

Late lodgments

Remember that late lodgments to some regulators, particularly with regard to taxation lodgments, carry lump-sum and interest penalties. Taxation penalties are usually equal to a proportion of the tax owing plus an interest charge.

There should be standard operating procedures in place that help your organisation manage the preparation for these deadlines. If you can see that you will not meet a particular deadline you may need to contact the relevant statutory authority and seek advice about extensions. Extensions may be readily understandable during a transition period to meet new requirements. Sometimes an extension requires a payment. Occasional missing of deadlines may simply indicate short-term pressures. Continuous failure to deliver may suggest a shortage of resources or systemic inefficiencies that need to be addressed.

The ATO's website provides a page with taxation information for businesses and organisations. Included is a list of key lodgment dates for the following statutory reporting requirements:

- Business activity statements
- FBT
- GST
- Income tax
- PAYG
- Superannuation

You can access this information at: www.ato.gov.au. Select the relevant topic from the navigation bars.

Support for team members

The provision of appropriate support is a significant key to successful financial management. Each staff member should have had a formal induction when they started work, providing them with the organisation's policies and procedures to help them carry out their day-to-day duties. Ongoing training through staff development and the provision of workplace learning opportunities should be part of an organisation's policies; there should be clear procedures that are used to identify training needs and methods for providing opportunities to fulfil those needs.



Support can be provided in many ways. Always use the most appropriate and cost-effective method.

You may like to read the book *Making sense of adult learning* by Mackeracher which is a very detailed look at how adults learn and how they can apply that knowledge to everyday, practical situations. It is useful for those who are involved with mentoring, coaching and shadowing as training techniques:

Mackeracher D 2004, *Making sense of adult learning*, 2nd edn, University of Toronto Press, Canada.

Also, a comprehensive book on coaching and mentoring by Nigro, which includes case studies may be of interest:

Nigro, N 2008, *The everything coaching and mentoring book: increase productivity, foster talent, and encourage success*, F+W Publications Inc., Avon, MA, USA.

Documentation of procedures

All financial procedures should be clearly documented in an organisation's policies and procedures manual. They should be easily accessible. You may wish to prepare simple overview sheets or flow charts to describe a particular function, or develop a series of checklists so that each step is ticked off when following the procedure. This is especially useful if a staff member needs additional help with understanding.

Methods of documenting and disseminating information are summarised below.

Intranet-based information

Depending on the size of the organisation, placing information on the intranet may be an efficient way of disseminating material. An intranet can be used to provide access to organisational information to support employees. Information related to financial management can include budgets and plans, procedures for performing specific tasks and relevant records. Access to specific files can be protected via security access using a password or security access procedure; for example, a fingerprint reader. Some organisations use the intranet as a training environment with particular courses listed.

Information briefings or sessions

Informal briefings or meetings can take place where relevant issues are discussed between colleagues or between an employee and supervisor.

Sessions can be formal or informal. Formal meetings or briefings with set agendas can be used to provide financial managers and people with budgetary responsibilities with key information relating to their roles, or as opportunities to discuss particular issues. A formal meeting can also take place where a supervisor informs employees on specific matters through face-to-face, teleconferencing or videoconferencing options. Team meetings are an efficient way of providing support as each member can contribute in a non-threatening environment.

Help desk or internal experts

Help desks are used as the first point of contact when an employee needs advice. 'IT Help Desks' are commonplace in many organisations and may provide support on hardware, software and internet problems.

Organisations can recognise people with exceptional skills and knowledge, and designate them as 'internal experts' to provide advice on issues within their knowledge and skill set.

Access to specialist advice

Specialist advice may be provided in-house from experienced, senior staff involved in financial management. An organisation might also take advantage of professional advice and training from external consultants for structured training sessions, or to gain a second opinion on an accounting standard or legal matter. Be prepared with a list of reputable experts in financial matters within your local area.

Training including mentoring, coaching and shadowing

An organisation's procedures also form a sound basis for training staff in performing tasks, for both new employees and current employees undertaking additional responsibilities.

Training should be ongoing. New employees should receive initial training through an induction program. All employees require training if their circumstances change, such as being promoted or being given additional responsibilities, or if new procedures are introduced.

Training can be formal through designated courses or activities provided either inhouse or by external entities. Such training can be on-the-job (work-based) or in a classroom setting on- or off-site. Training and learning can also be informal through casual exchanges or when an employee requires assistance.

Here are three ways in which training could be implemented in a workplace.

Mentoring

A mentor takes on the role of advisor or role model and is usually a more senior and experienced person. The employee works closely with the mentor, learning from their example. The mentor has knowledge, skills and experience to pass on, and does so by working closely with the learner on a formal and informal basis. It is usually a long-term arrangement.

Coaching

Coaching requires a trainer (supervisor or designated trainer) to work closely with the employee to achieve defined outcomes in terms of skills and knowledge. This approach is personalised and can cater for the specific learning needs and characteristics of the learner. As the learner progresses towards the objectives the coach provides support and guidance. Coaching generally has a designated time span.

Shadowing

Shadowing pairs an employee who is looking to develop new skills with a more experienced work colleague (trainer). The learner performs the tasks under the observation of the work colleague, who provides feedback and guidance.

Example: establish a mentoring program

Michelle has just joined the finance team at a medium-sized shoe manufacturing organisation. She is a recent graduate from university and has only had six months experience prior to joining the firm. One of her responsibilities is assisting department managers with the management of their budgets. Michelle reports to the finance manager, Freya, who was recently promoted to the position and started with the firm seven years ago in the same position Michelle now holds. Michelle has indicated she wishes to work towards achieving her professional year as an accountant and becoming a member of the Certified Practising Accountants (CPA). This requires a designated person to be a mentor and a member of the CPA, and Freya has agreed to be Michelle's mentor as well as her coach to bring her up to speed on the organisation's systems, policies and procedures.

Freya provides Michelle with a combination of coaching, in order to develop her skills and knowledge in the job, and acting as a mentor and role model for her studies towards achieving her professional year.



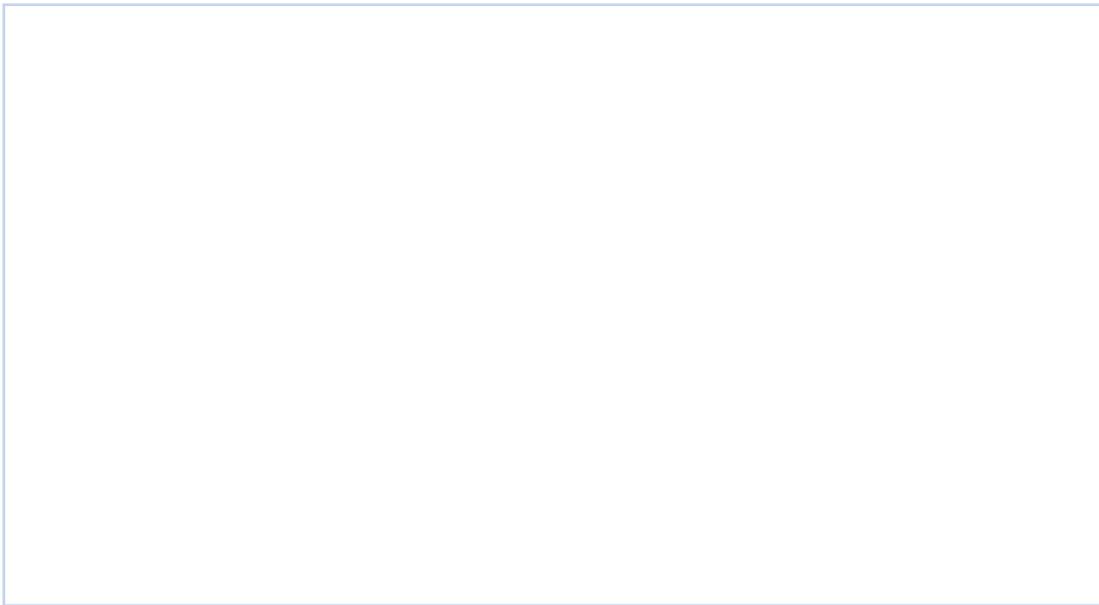
Practice task 6

1. Provide two examples of how a new employee can be supported in their financial management role.

continued ...

... continued

2. Provide two examples of how professional development occurs for current staff members who work in finance and have recently had an increase in their financial responsibilities.



2C

Use resources and systems to manage financial management processes

Financial management is concerned with the planning and controlling of an organisation's financial resources. It encompasses planning, directing, monitoring, organising and controlling of the monetary resources in an effective and efficient way to achieve the organisation's objectives. In order to do this, an organisation must ensure staff have access to the required resources and systems, so they can perform their functions effectively and efficiently.

Resources and systems required should have been identified in the budget and include sufficient qualified staff, an effective electronic management system, secure record-keeping systems, well-maintained equipment and machinery, adequate funds and appropriate time to meet deadlines. Managers need to ensure these resources are available and are used efficiently to manage the organisation's financial processes.

As well as managing the actual budget, the manager also needs to oversee any financial activities team members are responsible for such as banking, purchasing and payroll.



Human resources

Your work team needs sufficient resourcing to handle the varied financial tasks and responsibilities which may include purchasing, debt collection or handling the petty cash. This is in addition to other team-specific tasks including sales, marketing, and administration. You may need to apply for additional staff if you believe your team is understaffed. Staff numbers required should have been identified when planning the team's budget; you may find that you need to contract or outsource staff or look more closely at the make-up of the team and monitor the effectiveness of full-time, part-time and casual workers.

Members also need to be trained to carry out their allocated tasks. A manager needs to regularly monitor staff progress to ensure that staff are performing effectively, identify any skills or knowledge shortage and put plans into place to address them. Poorly trained staff can make it difficult for you to meet team and organisational goals within the allocated budget.

Physical resources

To manage finances effectively, a manager needs to make sure their work team has the physical resources they require to work efficiently. This may include office or factory space, computer equipment, furniture, storage, plant equipment and machinery, all of which must be in good working order and routinely maintained.

Identifying appropriate and cost-effective physical resources is part of budget planning so make sure you have determined precisely what your team needs. You might find that it is more cost-effective to lease or hire equipment, or purchase it second-hand rather than new. Follow the organisation's purchasing or procurement policies, practices and procedures to monitor and report on physical resources and asset life expectancy to ensure finances allocated to these items are well managed. Poorly managed equipment can lead to breakdowns, loss of time and subsequently, loss of money.

Financial resources

Financial resources include income from sales, loans and drawdown facilities or a line of credit, investor funds, owner's funds and budget allocations. It also involves expenditure related to purchasing and investing. Managing these resources can be demanding. For large organisations, specialist resource managers and their staff based in a department will often do most of the work relating to loans, dealing with banks and other financial institutions, negotiating investment funds and so on. Some financial management tasks/processes are listed below.

Financial management tasks

- Cashflow management – expected timing of income and expenditure and demands for future
- Purchase of physical resources and payments to staff and contractors
- Options for loans and overdraft to cover commitments when cash on hand is not sufficient
- Credit check on customers prior to granting credit
- Bad-debt management and debt recovery
- Short-term investment opportunities for excess funds

Hardware and software

An efficient information management system is essential for entering data, monitoring performance and controlling expenditure. Make sure you are up to date with current systems and practices. Ensure your team is well trained by arranging courses, coaching or mentoring.

Data management systems should include computer hardware systems for accessing the internet and operating email, and other communication systems such as an intranet or extranet. Software that provides the necessary tools to undertake tasks including word processing, financial analysis using spreadsheets or other financial programs, development of electronic presentations and communication via an email package and web/internet software.

Specialised systems that are generally software based include:

- human resource management systems
- payroll systems
- finance systems such as MYOB
- sales and marketing tracking systems
- customer relationship management (CRM) systems
- client or student administration management systems.

Record-keeping systems

All financial operations must be accurate, transparent, able to be tracked, carefully documented and easily accessible. Record-keeping systems are essential to monitor income and expenditure, and ensure all financial operations are well managed and available to be audited when necessary. Many large and medium organisations must comply with the Australian and International Standard, AS ISO 15489:2004 Records management.

There is a range of systems that exist inside an organisation that can be accessed and used by team members in relation to financial management. These can include record-keeping/ records management systems for the substantial range of records an organisation needs to keep for legislative purposes.

The records an organisation may need to keep include:

- financial records
- banking
- facilities and maintenance records
- payroll records
- employee-related records
- asset registers.

Types of record-keeping systems

Record-keeping systems may be electronic or paper-based but are generally a combination of the two; for example, job applications or leave forms and documents required by legislation, such as an employee's tax file number declaration, may be kept on an employee's file in hard copy, while other records may be kept on the payroll or human resources systems.

Some organisations may adopt a 'paperless' approach where all correspondence, written requests from clients, complaints, applications and so on are scanned and stored electronically, with an access system via computers and the intranet.

Specialist advice and support

Be able to identify the type of specialist support you and your team may need in regard to financial management. Keep a contact list of external entities that may be helpful such as the Australian Taxation Office, computer experts and financial consultants. You may need to call on:

- the organisation's finance department for specific advice on financial operations such as your budget, credit cards and record keeping
- the purchasing department for suggestions or information about new equipment needed
- human resources for advice on additional staff, payroll queries and outsourcing.



Time

Time is a valuable resource and time management an essential skill to ensure time is used effectively and not wasted on performing tasks that are irrelevant, could be delegated to others or are excessively time-consuming. You need to streamline procedures, set deadlines, delegate authority, and communicate expectations and requirements through appropriate channels in a timely fashion, follow up on deliverables from others and train your staff to carry out their responsibilities efficiently. Make sure staff tell you if they can't meet their time lines as this impacts your budget, and you may need to adopt contingency plans to bring the work back into the designated time frame.



Example: conduct approvals more efficiently

Gary is the purchasing officer for a medium-sized company. The current system for approving the purchase of goods and supplies requires the signatures of the relevant manager on hard copy internal forms. Sometimes this approval can take over a week from the initial request from an employee for certain items before arriving in his office and his staff taking action and placing the order.

After consulting with the IT team and financial systems experts, it was arranged that administrative staff for each department can place an order electronically on the finance system and log it. The system considers the request, matches the staff number of the person requesting the purchase and sends a summary to the designated authorising officer, who can authorise the purchase electronically; if the purchase is in excess of the authorising officer's limit, the details are sent to the manager for approval.

Approvals now take one working day and approximately 90 per cent of orders are placed with the supplier within one working day.

Example: review the budget development process

Kris is the chief financial officer of a medium-sized service organisation. Recently, after having presented the organisation's budget, he receives numerous comments that suggest the organisation lacks an understanding of how the budget impacts on employees and the mechanisms that are in place to develop the budget. He is also concerned that some of the employees have supervisory responsibilities in their cost centres yet have had little financial training.

As a result, Kris reviews the current budget development process. He also considers the strategies used to disseminate budget information during the development phase and post approval. Kris meets with the human resources manager and finds that there has been relatively little formal training carried out in relation to budgets and financial management. His research suggests that the level of knowledge and skill in the workplace is substandard and that the support being provided is also inadequate.

Subsequent to his investigations Kris raises the matter at the next meeting of cost centre directors with the following recommendations:

- There needs to be greater dissemination of budgetary information during the development stage.
- All employees with any supervisory responsibility need to undergo a basic course relating to interpreting and understanding budgets and performance reports.
- The communication policy and procedures needs to be reviewed.

Practice task 7

Write approximately half a page (using dot-points) to plan how you will determine and access each of the following resource types to manage financial processes.

- Human resources



continued ...

... continued

- Physical resources



continued ...

... continued

- Financial resources



Summary

1. A budget is an indication of the direction that a cost centre is intending to take and relevant information must be disseminated to relevant personnel and teams. Each cost centre must be aware of the corporate objectives and how their budget relates to these strategic objectives.
2. Approved budgets and relevant information needs to be communicated to all relevant employees in a form that is understandable and that clearly enunciates their budget responsibilities. Dissemination can be in the form of formal meetings, group sessions, written communication, face-to-face presentations or electronic communication.
3. People should have sufficient time to study the financial plans and note whether any points they had brought up in the developmental phase have been addressed.
4. Those responsible for the management of budgets and finance must be provided with the appropriate support, such as training, information sessions and access to specialist advice.
5. Work teams must be supported with the appropriate resources and systems including adequate physical resources, training and effective software systems. Failure to provide the necessary support and tools for work teams may lead to inefficiencies and an inability to achieve the best outcomes for the team and organisation.
6. Documented procedures are an essential component of the support resources required for financial management and they must be available to all relevant personnel in appropriate formats.

Learning checkpoint 2 Implement financial management approaches

This learning checkpoint allows you to review your skills and knowledge in implementing financial management approaches.

Part A

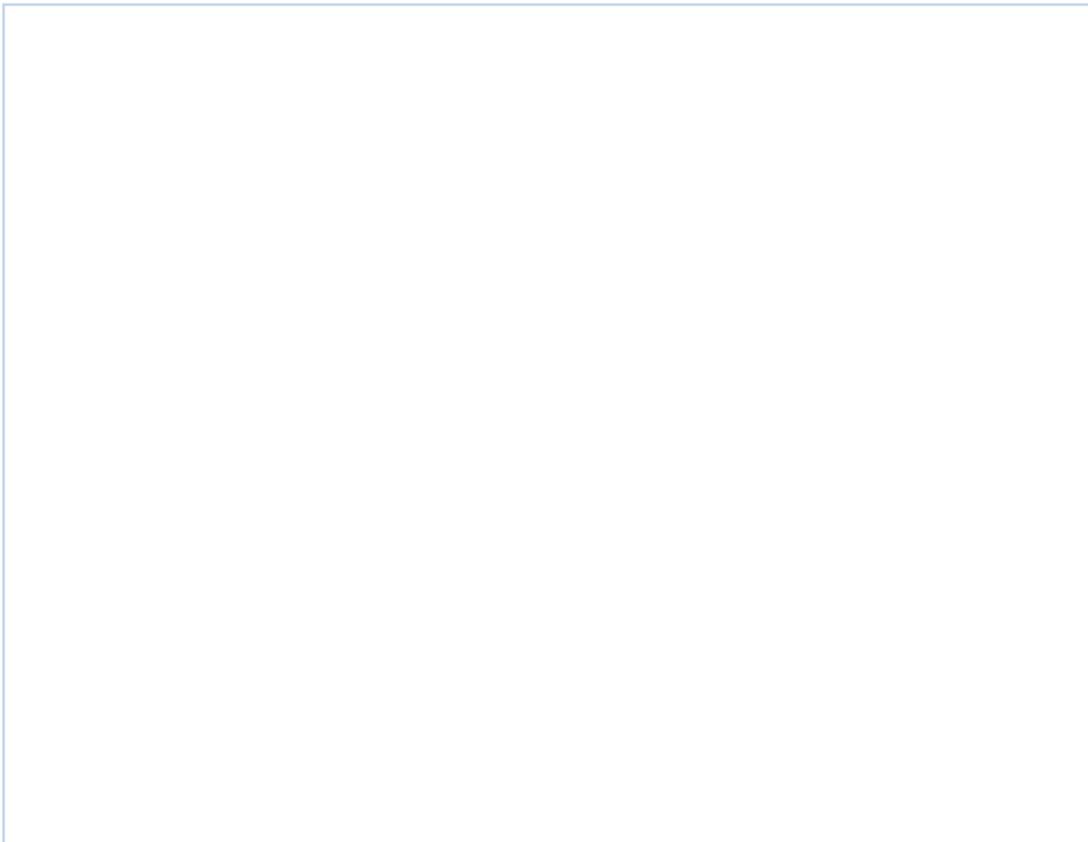
1. Describe a budget development coordination and approval process.



2. What information should be disseminated to cost centre managers in relation to budgets and plans?



3. To what extent should a team be involved in budget development? Give examples.



4. For what reasons might you adjust the format or methods of communication about budgets to employees?

5. Why is timing a relevant consideration in communicating budgets?

6. What legislative requirements do people with financial responsibilities need to understand?

7. Identify and describe four different types of support that you might provide to employees who have responsibilities in relation to implementing budgets or carrying out financial tasks. How is this support delivered and the effectiveness of it monitored?



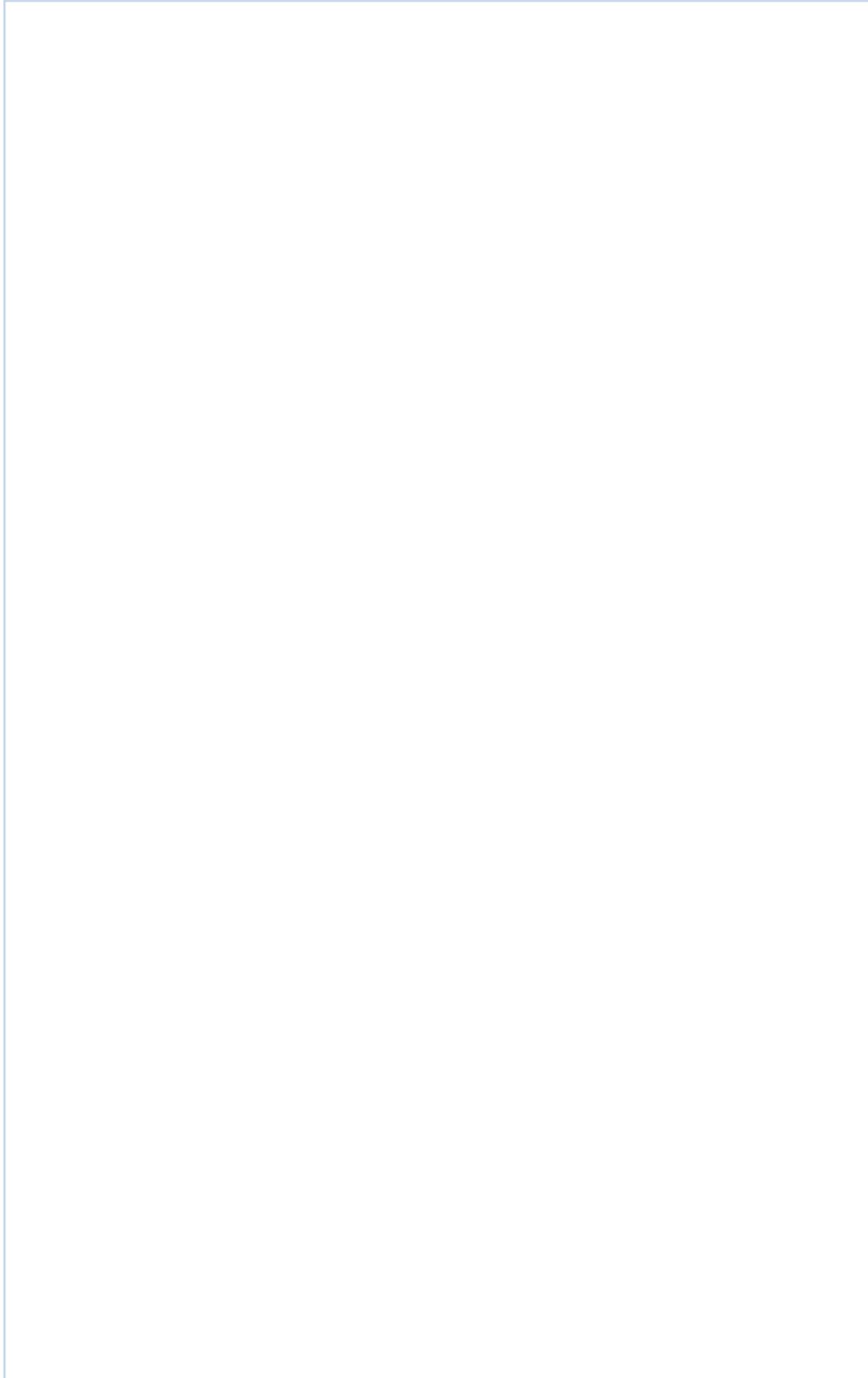
8. Budget management involves the acquisition of resources in order to achieve the objectives of a budget. Explain how human resources, physical resources and financial resources need to be identified and accessed to ensure the following:

a) The team's budget is met

b) Financial operations are carried out effectively

9. List at least six procedures that exist in an organisation relating to financial management tasks.

10. Under what circumstances would you recommend to a colleague that they sought specialist advice in relation to budget management? Where would that advice be sourced and why?



11. Why is records management important? What are the potential consequences of having a poor records management system?

12. Complete the following tasks using a typical group or team in a business organisation for which you are familiar.
- a) Describe the team and provide an overview of its responsibilities within the organisation.

- b) List the main financial duties of the team; for example, purchasing, invoicing and keeping track of hours.

- c) List the main items in the team's budget.

d) Prepare a training session in which you disseminate the budget to the team.

e) List the resources and systems that team members need to be able to use.

- f) Describe the record-keeping software or other relevant system that is used by the organisation to record financial information.

Part B

Read the following case study, then complete the tasks that follow.

Case study

Hugo is the manager of a medium-sized retailing operation and is concerned about the collection of monies for goods sold. He has a current policy for collecting monies from credit customers and all goods are sold on credit. He has actual sales data for the first six months of the financial year and projected sales figures for the six months to credit customers.

He wishes to consider the impact of adjusting the policy and has two proposals in mind. The policies are below.

| Timing of payment | Payment under current policy | Projected payment under policy option 1 | Projected payment under policy option 2 |
|----------------------|------------------------------|---|---|
| 1st month after sale | 60 % of monies collected | 80 % | 90 % |
| 2nd month after sale | 25 % of monies collected | 12 % | 5 % |
| 3rd month after sale | 14 % of monies collected | 7 % | 3 % |
| 4th month after sale | | | |

continued ...

... continued

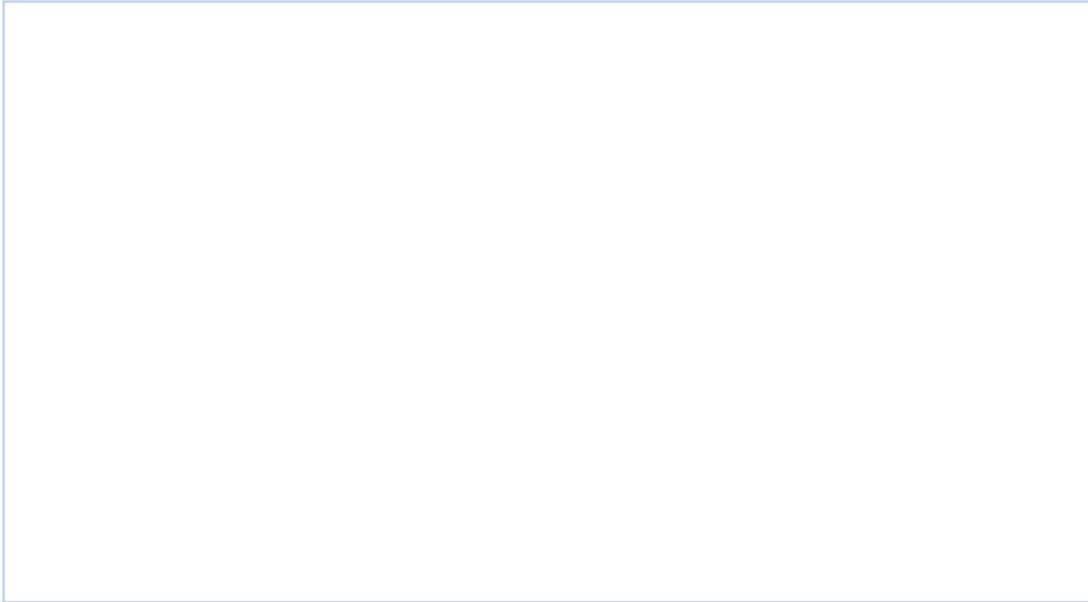
His sales figures are as follows.

| Sales figures | | | |
|------------------------------------|-----------|--------------------------------------|-----------|
| Actual for first six months | | Predicted for next six months | |
| July | \$100,000 | January | \$120,000 |
| August | \$115,000 | February | \$125,000 |
| September | \$115,000 | March | \$125,000 |
| October | \$100,000 | April | \$120,000 |
| November | \$120,000 | May | \$120,000 |
| December | \$140,000 | June | \$110,000 |

There is one additional question Hugo wants answered: Is there any advantage from a cashflow perspective of offering a two per cent discount if accounts are settled in the first month? His view is that most of his customers would pay in the first month and the remaining would pay in the next month, and no bad debts would need to be written off.

1. Analyse the optional policies and make a recommendation to Hugo as to which policy he should consider as the better option. Include in your response a projected cashflow spreadsheet for each of the proposals.

2. Provide feedback on Hugo's additional question.

A large, empty rectangular box with a thin blue border, intended for providing feedback on Hugo's additional question.

Topic 3

Monitor and control finances

Setting and having financial plans and budgets approved is only the first part of financial management. In order to determine whether the organisation is achieving the objectives that have been set, budgets need to be closely monitored and controlled. Appropriate processes need to be in place so the financial manager can identify where there are variations or deviations from the budget and take corrective action. The main focus is to monitor expenditure to identify where there may have been either positive or negative variations from the budgets and put contingency plans in place to correct or reduce the potential problems.

In this topic you will learn how to:

- 3A Implement processes to monitor actual expenditure and to control costs across the work team
- 3B Monitor expenditure and costs on an agreed cyclical basis
- 3C Implement, monitor and modify contingency plans as required to maintain financial objectives
- 3D Report on budget and expenditure in accordance with organisational protocols

3A

Implement processes to monitor actual expenditure and to control costs across the work team

The size and nature of an organisation, its structure and the management style determine the relevant approach to monitoring and controlling expenditure and the costs incurred. An objective for most organisations is that they make a profit; not-for-profit organisations aim to break even.

Profit is the difference between revenue earned from goods and services sold (outputs) and expenses. Some cost centres may only have expenses and no revenue, as their work contributes to the organisation's operations but does not itself receive actual revenue. Where cost centres have both revenue and expenses, the cost centre itself can be considered a profit centre, in that it is an entity that makes a profit (revenue is more than expenses) or a loss (revenue is less than expenses). The manager of the cost centre is generally responsible for controlling the costs and managing the resources within their cost centre.



Understand cost elements

It is important that managers understand the various costs associated with an organisation's operations and how they are applied to the budget.

To produce a product or service requires materials and labour that must be purchased. Organisations also have other costs that are not directly attributable to the materials or labour of the goods or services and these are called overheads. There are generally four cost elements involved in the production of a product or service, all of which need to be identified in the budget and recorded as part of the expenditure monitoring process. These are listed and described below.

Direct materials costs

Direct materials costs are the cost of the materials that are used to produce a product or service; for example, wood, cloth and springs for manufacturing a couch; parts for the repair of a car. The cost of these materials can be determined by analysing the quantity of each input used and multiplying the result by the cost of each input used. Job cost sheets can be used to ascertain the materials used; for example, when a vehicle is serviced there is a list of parts and materials used, with each item having a specific cost against it (this is not necessarily the 'true cost' to the business as there may be a mark-up on those items).

Direct labour costs

Direct labour costs are the cost of the labour used to make the product or deliver the service; for example, wages of the person making a couch or repairing a car, salaries of the accountant, lawyer or doctor. The hours worked by an employee on producing a product or service can be used to calculate the direct labour cost of the product or service based on their salary or wages. A job cost sheet can be used to record the actual cost of direct labour. (When an invoice or detailed service sheet is presented; for example, for work done on a car, the hourly rate for labour is not the hourly rate that the service mechanic gets paid as it incorporates other indirect labour costs and overheads.)

Overhead costs

Overhead costs are the costs that cannot be directly linked to the production of a good or delivery of a service but are required in order that the goods and services can be provided. This can be further subdivided into three areas:

- Indirect materials costs or consumables; for example, glue used for furniture making, oil remover for cleaning car parts, paper or envelopes used in an office.
- Indirect labour costs; for example, wages of people who are not directly working on the product or service such as the receptionist, workshop supervisor or security person. Other indirect labour costs that need to be determined include holiday pay, sick pay or maternity leave, the superannuation contributions that the employer has to pay for each employee. These are added to overheads.
- Indirect or other expenses; for example, rent, water rates, electricity, maintenance.

Overhead costs for a cost centre can be allocated a number of ways. These include:

- determining the overhead cost per hour for billable labour hours and adding this to the actual labour rate.
- determining the overhead cost per job for the anticipated number of jobs to be done and allocating an initial job fee or service fee.
- determining the overhead cost per hour for a process such as the ordering and management of supplies/materials and adding a mark up on the purchase price of the materials to cover it.

Fixed or variable costs

Costs are also classified as fixed or variable costs:

- Variable costs are those that are directly related to the production of a good or service. Increase production by 10 per cent and the direct materials and labour costs will also increase by 10 per cent (unless this pushes the work force into overtime payments).
- Fixed costs do not change, such as the wages associated with a supervisor or the rent of office space, as these are not directly related to the production of the goods or services.

Practice task 8

1. Describe the relationship between direct labour costs and variable costs.

2. Describe the relationship between fixed costs and overhead costs.

3B

Monitor expenditure and costs on an agreed cyclical basis

A manager's job is to implement processes to monitor actual expenditure. A key part of monitoring expenditure is to record information, identify cost variations and expenditure overruns and report results to the relevant personnel and teams responsible for financial and budget management on an agreed cyclical basis.

The following need to be recorded:

- Levels of production and income generated and direct costs associated with each different product.
- Quantity of service provided and income received for each service and direct costs associated with each of the different services provided.
- Corporate or business overhead costs that need to be covered from across the whole organisation.
- Overhead costs that are attributable directly to a specific cost centre.



Understand performance indicators

Performance indicators are developed using the income and expenditure of doing business; the actual income and costs are compared against the planned income and costs as expressed in the team's budget. Reports are produced to identify performance, enabling management and cost centre or budget managers to take appropriate action to correct issues that are identified by a variation between budget position and the actual position at a point of time in the budget year.

Performance indicators are grouped into financial and non-financial groups.

You may like to read a book which provides an overview of the various methods used over time to measure business performance:

Neely, A 2002, *Business performance measurement – theory and practice*, Cambridge University Press, Cambridge, UK.

Financial performance indicators

Financial indicators include profit, changes in balance sheets, market share fluctuations and returns on capital investment. Some examples of these indicators are shown here.

Profit indicators

Profit or return indicators; for example:

- gross profit against sales (measured as a percentage)
- net profit against sales (measured as a percentage)
- gross profit against labour cost component of goods sold (measured as a percentage)
- net profit against labour cost component of goods sold (measured as a percentage).

Balance sheet changes

A change in the balance sheet, providing a picture of the cost centre's financial position at a point in time; comparing the balance sheet as an increase or decrease from the previous reporting period.

Market share

Market share, the percentage of your company's sales of a product against total sales (yours and competitors) for a designated area, region, state; for example, your beer brand has 14 per cent of the market.

Return on capital

Return on capital investment – net profit against capital invested as a percentage; for example, \$30,000 net profit on \$1 million capital investment would be three per cent.

Non-financial performance indicators

Non-financial performance indicators focus on various activities related to an organisation or a component part of an organisation. Such indicators will be substantially different depending on the nature of the business undertaken in varied areas of the organisation.

Note that although non-financial indicators are not measured in financial terms, the failure of an organisation to address the cause of unfavourable indicators in these areas will ultimately impact the bottom line of the organisation. Non-financial indicators vary according to the nature of the business; however, many common indicators are shown here.

Customer complaints

Measured as a number or percentage of customers/clients served; the lower the number the better.

Lost-time injuries

The number of days lost as a result of injuries (accidents) measured as a number of days and/or a percentage of total days (hours) worked.

Employee attendance

Absenteeism without prior approval.

Staff turnover

Usually measured as a percentage of total number employed; for example, 20 per cent turnover in three months might be considered a negative indicator, as new staff need to be recruited and given induction training, which comes at a cost.

Machine breakdown

Hours lost on failure of equipment measured as a rate of hours operating or lost hours.

Record expenditure

The monitoring of expenditure requires that each item of expenditure is recorded appropriately against the relevant cost codes used in the organisation's chart of accounts and in the development of the budgets. Similarly, income from the various products and services should also be recorded against the relevant code from the chart of accounts.

Reports are generated that measure the position of the cost centre and organisation at a point in time against the financial plans and budgets. Such reports provide information that may be the basis for control decisions made by a manager or the basis for further investigation to determine if action is required. These reports should be prepared according to the organisation's agreed cycle of reporting; for example, monthly or quarterly.

The accurate recording of expenditure is critical. Here is an outline of some of the expenditure groups that should be reported.

Assets

Assets are what a business owns and can include land and buildings, vehicles, plant and equipment, goods held in stock, monies owed to it (accounts receivable) and any cash in the bank. An annual stocktake of assets and their condition is essential.

Consumables

Consumables are indirect materials costs that cannot be directly attributed to the specific production of a good or service; for example, paper and toner for the printer, paper clips etc. in an office). These must be recorded so the organisation knows what consumables it has on hand at any one time.

Equipment

Equipment is that used in the manufacturing of a product or service where the cost can be attributed to that product or service generally as a cost centre overhead, along with any maintenance or consumable costs associated with the equipment.

It can also include equipment that is used across a number of cost centres, with the costs recorded in overheads and allocated accordingly to cost centres. Recording equipment is included in the asset stocktake.

Expenditure

Expenditure is what a cost centre needs to spend in order to achieve its goals. Expenditure needs to be reported for each cost centre in journals and ledgers in accordance with the requirements of the organisation, in line with the chart of accounts (classifying all financial transactions as assets and liabilities or revenues and expenses) and in a manner consistent with the format of their budget.

Income

Income is monies received from the sale of products and services, income through investments, and donations. Accurate ledgers and financial statements must be maintained.

Stock

Stock is finished products on hand and potentially in storage and/or materials in stock to be used in the production process. Costs of storage are also included here. Regular inventories and stocktakes are essential and must be recorded accurately.

Wastage

Utilisation of materials is an important factor. Excessive waste can erode profits and/or initiate a rise in the price of goods and services sold, making the organisation less competitive against its opposition.

Variance analysis

The reports provide a comparison of the 'budgeted' income and expenditure against the 'actual' income and expenditure, which results in a variance that shows the difference between 'actual' and 'budget'.

An essential part of monitoring expenditure is to regularly track the variance and analyse results to identify cost overruns or whether the team is meeting its budget.

The following table is used to consider whether 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 |

Example: an aggregated report

Report on performance for December 2017

| 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 |
| Sub-total | 97,000 | 76,000 | 21,000 F |
| Profit | 13,000 | 39,500 | 26,500 F |

This report suggests that this business is doing quite well. Sales are up five per cent on budget (F = favourable). 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).

Acceptable variation between budget and actual results

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

Variance analysis is commonly reported on a monthly basis. Care should also be taken to ensure that annual expenditure patterns are taken into account; for example, if insurance is budgeted at \$2,400 for the year, then the expected monthly expenditure would be listed as \$200 per month. Therefore, if insurance is paid annually in August (the second month of the financial year), the budgeted amount could read \$400 but the actual amount would show \$2,400; this would suppose an unfavourable position, but in reality it is acceptable as you have paid the insurance for the whole year. Barring any changes in premiums or additional insurance costs, the end result is on budget.

You may like to read a book that offers a detailed overview of methods for assessing business performance:

Helfert, E. A. (2001), *Financial analysis tools and techniques – a guide for managers*, McGraw-Hill, New York, pp. 95–160.

Reasons for variances

It is important to determine the reason for the variances. You may have to put controls in place to ensure budgeted costs are maintained.

When considering the variations look for an explanation and determine if action needs to be taken. Simply shifting savings (low expenditure – money not spent) or additional income (excessive income – extra money received) to overruns on costs or to offset a lower-than-expected income area is not addressing the cause and has the potential to mask the true position which, if left unaddressed, may get worse. Managers must be able to monitor and present financial data using electronic spreadsheets and other software associated with financial record keeping.

Some examples of variances, whether they are favourable or not and suggestions about their cause are presented here.



Frequency of monitoring and reporting

Variance analysis is often undertaken on a monthly basis. To undertake a less frequent monitoring approach (say quarterly or six-monthly) could mean that corrective actions could occur too late. Less frequent monitoring can also mask the trends or seasonal issues.

On the other hand excessive monitoring and reporting can be time consuming and provide little additional information of benefit to managers. Exceptions would be in particularly volatile industries or where prices of direct materials can vary substantially in short time periods; for example, fuel costs.

Example: the impact of seasonal factors on a budget variance

Josephine runs a small business making children's clothing for local retail stores. She employs people to sew and produce the clothes. Her budget is based on sales being averaged across 12 months at \$10,000 per month.

At the end of September (month 3) the variance is as follows:

Income variance – September

| Item | Budget (\$) | Actual (\$) | Variance Result |
|--------|-------------|-------------|-----------------|
| Income | | | |
| Sales | 30,000 | 7,500 | (22,500) U |

The main reason for the variance is the seasonal demand for her products. She has been producing clothes for the upcoming summer and though she has orders, they won't be filled until October, in time for the summer stock to be in the stores.

Income variance – October

| Item | Budget (\$) | Actual (\$) | Variance Result |
|--------|-------------|-------------|-----------------|
| Income | | | |
| Sales | 40,000 | 50,000 | 10,000 F |

Implement control processes

Once actual expenditure has been identified, a manager needs to analyse the results to see where and how they can make adjustments if expenditure is more than budgeted for and there have been cost overruns. Their job is to implement processes to control costs across their work team.

Controls are processes that are designed to provide guarantees that:

- the operation of the business is effective and efficient, its resources are protected and it achieves its objectives
- the financial reporting on performance is reliable and consistent, in that reports are accurate and a true reflection of the position and performance of the organisation
- the organisation is complying with any relevant legalisation, codes of practice and internal organisational policies and procedures.

Investigate cost overruns

Once it has been identified that costs are outside the budget, it's important that the matter is investigated to find out why and then appropriate action taken. In noting a variation from the budget the steps taken should be in accordance with the procedures of your organisation.

Commonly used steps to investigate cost overruns follow.

Steps to investigate cost overruns

Seek confirmation of the variation by analysing source documentation relating to the areas of expenditure.

If the variation is confirmed, determine if there are any seasonal factors or ordering time lines that may have contributed to this variation or that the budget expenditure has been evenly spread across the twelve months.

Document the reasons and advise your supervisor but continue to monitor the situation.

If, after seeking input from your team's members, the matter cannot be justified, detail the situation and report this to your supervisor.

Report cost overruns

In reporting the matter to your supervisor, it is appropriate to provide any supporting documentation or analysis that forecasts the position at the end of the year in relation to the cost overruns. You should understand the nature of the business and operations for your area of responsibility, and include in your report options for controlling the costs and minimising the impact.

Many of the approaches to controlling costs should have been considered well before the cost overruns are detected. Plans should be developed that can be used in the event of such an event occurring.

Cost overrun control processes that can be implemented include those shown below.

Team consultation

Ask team members to provide options and input for reducing costs in order that decisions can be made on potential savings.

continued ...

... continued

Spending

Advise all team members of the need to reduce spending including the amounts involved and provide a list of categories to focus on.

New equipment

Place a ban on the purchase of new equipment or implement a process where justification is required for such purchases and a higher-level authorisation must be obtained.

Salary and wages

Reduce overtime or salary and wages through use of less casual staff or encourage long service leave to be taken if funds to cover this are held outside your budget area.

Travel costs

Reduce travel expenditure by limiting travel to critical trips only and employ other communication methods such as videoconference calls.

Expenditure

Put a stop to non-essential expenditure and redirect funds to areas of cost blow-out, which may involve production of a mini-budget or budget variation.

Example: reduce costs

An organisation decides to merge two separate administrative areas and relocate them to a single location in an attempt to reduce costs. Tim is appointed to manage the budget and financial plans of the newly combined entity. The first steps taken by the new manager is to liaise with the various budget personnel and team members in each of the separate areas to determine which expenditure areas might be reduced and what cost savings might be achieved.

After this consultation meeting Tim provides a draft document for comment on options for cost reductions and new procedures that must be followed. After some further discussion and refinement a number of actions are taken to reduce the costs. Some of these include:

- Ordering of materials such as stationery must be done by considering the needs across the whole new entity before ordering.
- Equipment purchases such as new printers and photocopiers must be capable of servicing a larger group of staff, so the demand for such equipment should be reduced.
- With some duplication in responsibilities position descriptions are to be adjusted, and when an employee leaves the organisation, combining their responsibilities into existing roles is to be considered before seeking a replacement.

Practice task 9

Insert the missing values in this variance table.

| Item | Budget (\$) | Actual (\$) | Variance result |
|----------------|-------------|-------------|-----------------|
| Income – Sales | | | |
| Product A | 400,000 | 350,000 | |
| Product B | 125,000 | | (5,000) U |
| Product C | | 80,000 | 20,000 F |
| Costs – Sales | | | |
| Material X | 60,000 | 56,000 | |
| Material Y | 45,000 | | (3,000) U |
| Material Z | | 30,000 | 1,000 F |
| Direct labour | 100,000 | 105,000 | |
| Overheads | | 7,525 | 125 F |

3C

Implement, monitor and modify contingency plans as required to maintain financial objectives

Contingency plans are developed as part of the budget development process, so if something goes wrong and the team is heading towards a cost overrun, then prompt corrective action can be taken.

Contingency plans are implemented as the result of a trigger and once implemented these plans have to be monitored and appropriate reports produced. Contingency plans need to be reviewed during the financial planning period on an ongoing basis to ensure that they are still current and will work in the event that they are needed.

Triggers for implementing contingency plans

There are various triggers that can initiate the implementation of contingency plans in order to maintain financial objectives. Triggers to consider the implementation of a contingency plan need to be significant in that the variation or impact of the event or observed variation is such that failure to respond makes things worse; a variation of \$1 in a \$1,000 in a cost line or a 0.25 per cent fall in income from a particular product or service are both unlikely to be considered significant in terms of achieving financial objectives.

Below are some examples of trigger situations for implementing contingency plans and a suggested control measure for each.

Supply

Situation:

Notification that a supplier will no longer be able to supply materials required as they have gone out of business.

Control measure:

Identify another preferred supplier. Implement a plan that sources the materials from elsewhere, possibly sourcing recycled materials as inputs.

Competition

Situation:

Notification or observation that another competitor has entered the market and is competitive on price.

Control measure:

Spend additional resources on marketing and promotion in an effort to combat the competition, or reduce production and transfer resources into other products and services that are not 'under threat'.

Cost blow out**Situation:**

Analysis of budget cost variance reports that indicate specific costs are blowing out.

Control measure:

Source materials from elsewhere. Outsource some functions; for example, maintenance or recruitment functions.

Sales decline**Situation:**

Sales and income reports indicate a drop in sales of specific products.

Control measure:

Increase promotion, and reduce production.

Government changes**Situation:**

Government actions cause an increase in company taxes or fees, such as import duty.

Control measure:

Adjust budget overheads and increase the price of the product or service to correspond to tax or fee increase. Implement alternatives for sourcing required materials domestically.

Implement contingency plans

The implementation of contingency plans is a decision taken by managers in an effort to address a divergence from the financial plans that are in place. The purpose of implementing contingency plans is to maintain the team's (and organisation's) progress towards achieving its strategic objectives. Effectively the aim is that any significant, unfavourable variances in the budget variance analysis reports become more favourable in the future reporting periods.

Contingency plans should therefore clearly support the objectives of the organisation and be focused on reducing costs when a variation between budgeted and actual expenditure is discovered.

If the contingency plan is common for all cost centres/departments, it may need the authorisation of the CEO before it can be implemented.

Monitor contingency plans

The implementation of a contingency plan means a change to the budget and operational plans of a cost centre or organisation. Contingency plans that have been implemented need to be monitored to determine whether they are resolving the problem, having no impact or making the situation worse. Appropriate analysis techniques in addition to variance analysis on budgets may need to be considered.

Below are the outcomes and possible additional actions as a result of contingency plan monitoring.

Successful outcome

If the contingency plan works and a cost centre is back on track, no further action may be necessary other than continued monitoring.

Minimal or no impact

If implementing the contingency plan has minimal or no impact, or makes things worse, it has failed. In such a situation further action needs to be considered, such as the implementation of additional contingency plans that may involve areas or work teams outside the single cost centre. Where outcomes fall into this secondary area, plans need to be revisited.

Review and modify contingency plans

Contingency plans should not be left in a drawer or on a shelf pending their potential implementation. Contingency plans should be reviewed as part of the ongoing management of a cost centre and the associated budgets to ensure that they are functional if required; for example, if a contingency plan for the sudden loss of labour in a production environment recommends a casual labour source, but the source cannot provide the level of labour required, the plan is worthless. Similarly, strategies for reducing costs by renting may no longer be appropriate if rental costs have increased.

Contingency plans should be modified as, and when, issues are identified that indicate they would fail to correct a problem or could be more effective.



Example: implement contingency plans in response to a sales decline

Isabel is the manager of the sales department in Direct Meats, a small food-processing manufacturing plant. There has been a recent drop in sales as a competitor has introduced the same product. The budget variance reports indicate that Direct Meats is not going to achieve the targets for the year. Furthermore, there is an excess of the product in the warehouse. The first contingency plan implemented by Isabel is to increase marketing strategies for the product and have sales representatives promote it heavily to customers. After two weeks there is no significant increase in the orders.

The second contingency plan implemented 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 the competing product lessens. However, contingency plans need to be reviewed and updated as the situation with the competitor is monitored.



Practice task 10

Think of an example where it would be necessary to implement a contingency plan in relation to budget management. Provide brief details for each of the following.

1. What led to the identification of the issue and what objectives were not going to be achieved

2. The details of contingency plan that could be implemented

continued ...

... continued

3. The monitoring that should take place in relation to the effectiveness of the contingency plan

4. The eventual outcome

5. What reports could be generated in relation to the issue and the actions taken

3D

Report on budget and expenditure in accordance with organisational protocols

Monitoring and controlling budgets is a major part of the role of a cost centre manager and others with budgetary responsibilities. Another key component is that of appropriate reporting on budgets and expenditure.

Budget and expenditure reports act as a formal record of achievements and issues that have arisen and document the reasons for decisions made. Reports can also provide input into decision-making at higher levels or across a range of cost centres and activities of the organisation, and be used in reporting to external authorities such as regulatory bodies and other stakeholders.

Reports not only provide a commentary on the past and the present situation but, importantly, contribute to the decision-making process that assists an organisation in making appropriate decisions in order to achieve objectives. Reports on the past can also provide extremely important input into the future planning process.

You may like to read a book which provides guidelines on preparing, writing and presenting reports:

Bowden, J 2008, *Writing a report – how to prepare, write and present really effective reports*, 8th edn, How to books Ltd, Oxford, UK.



Prepare financial reports

Follow the organisation's procedures for preparing financial reports. Be familiar with the organisation's financial reporting calendar and know when reports are needed and how they are to be presented. The calendar includes submission dates of reports to meet statutory requirements as well as organisational deadlines. In particular, you need to be familiar with the principles and techniques involved in preparing ledgers, profit-and-loss statements and other financial statements used in managing cashflow.

Be familiar with:

- the types of financial reports generated by your organisation
- the format in which they should be presented
- the type of information required
- when they are due.

Categories of reports

Reports may be categorised into three main types, which are described below.

Regular reports

Regular reports (also called standard or periodic reports) that are produced to report on activities such as budget management and expenditure, including profit-and-loss statements, cashflow statements and balance sheets, or to report to appropriate authorities such as the ATO. These reports are generally brief; for example, a report on the monthly variance analysis, performance against budget, actions taken and explanations of anomalies or issues that have arisen. These reports include tables, diagrams and pie and bar charts to indicate budget expenditure.

Progress or project reports

Prepared to describe achievements up to a specific period. The focus is on achievements against a plan, issues being faced, actions taken and recommendations on maintaining project deliverables.

Requested or issue-generated reports

May be requested from higher authorities or initiated in response to a particular situation or issue; for example, a report on options to address events that have a significant impact on a cost centre being able to achieve objectives, such as a shortage and significant increase in the price of raw materials.

Financial reports

Information or data for compiling financial reports on budget and expenditure management can come from a range of sources as outlined below.

Bank statements

Bank statements provide evidence of transactions (deposits and withdrawals) and can be used to reconcile against financial system records. Also used to determine bank charges and any interest that might be paid.

Credit card statements

Credit card statements provide a record of expenditure along with substantiation documentation if required. They are also used for payments of the credit card accounts.

Financial reports

Profit-and-loss reports and balance sheet reports detail the financial performance of the organisation and its current financial position.

Invoices and receipts

Invoices and receipts provide details of monies owed and monies received.

Ledgers and journals

Ledgers are the database for an organisation's accounting records. Journals are the details of the transactions and include authorisations for adjustments made to the ledger. Financial statements are generated from ledgers using the chart of accounts.

Logs

Logs provide details and records on:

- hours worked for wages; for example, time sheets
- motor vehicle usage; for example, car log book
- equipment operations; for example, hours of operation of major equipment
- maintenance log books and service records for equipment.

Petty cash records

Petty cash records provide details on the nature and amounts of expenditure via the petty cash system.

Spreadsheet records

Spreadsheet-based records are generally associated with the operation of a small to very small business. Many use software such as MYOB (Mind Your Own Business) or QuickBooks in order to generate relevant reports they wish to use and the reports they require at the end of the financial year for tax time.

Tips for preparing a report

A report should be prepared and planned with a clear objective in mind and knowledge of the reader. Some tips for writing reports are shown below.

Characteristics of good reports

- Well-structured according to requirements; for example, a title; executive summary (if appropriate) with an overview of the area, analysis undertaken with findings and recommendations; introduction; body; conclusion; reference list and appendix if required.
- Accurate and complete – it provides a full view and is not focused on one perspective; it includes all information required to make a decision or move forward.
- Genuine – data is from a trustworthy and honest source.
- Targeted and mindful of the reader – it is written in understandable language with the appropriate use of diagrams and graphs so it can be understood.
- Positive and proactive – it is concerned with the future and leads in that direction.
- Well-timed – it is appropriate to the time when decisions need to be made.

Things to avoid

- Inaccurate or conflicting information and comments
- Outdated or irrelevant data
- Facts and opinions intermixed
- Conclusions and recommendations not supported
- Poor presentation, spelling and grammatical errors
- Fancy visual appearance and lack of attention to content

Example: prepare appropriate reports within deadlines

Sanjit is the budget manager for a cost centre that has a turnover of over \$10 million a year in an organisation that turns over more than \$120 million a year. He prepares a monthly variance analysis with a report on any variations to his supervisor, the cost centre manager.

Sanjit provides a comment against any variation in the report and, where significant variations are observed, he researches the situation and makes recommendations on contingency plans that could be considered.

Sanjit also undertakes a trend analysis so he can consider the income and expenditure over the preceding months to determine if there is a trend developing. He also compares each month's position against the position at the same time in the preceding year if appropriate.

The report has to be with his supervisor one week after the release of the variance reports so Sanjit makes sure this is entered into his diary so he can complete the report on time.

Example: set variance guidelines

Seven team managers report to Franco, the new budget controller, who reports to the chief financial officer (CFO). Each of the seven managers receives a standard budget variance report at the end of the month and is expected to provide a report to Franco so that he can compile a single report to the CFO. The quality of reporting to Franco varies, making it difficult for him to analyse the individual reports and to therefore provide a consistent and meaningful report to the CFO.

Franco decides to set specific guidelines for each manager to report on the following:

- Any variation of more than five per cent for budgeted items up to \$50,000.
- Any variation of more than three per cent for budgeted items greater than \$50,000.
- Any budgeted item where the variation has continued to increase over three consecutive variance analysis reports.

To assist them Franco has the variance analysis report on the system modified to place a 'flag' next to any items that require a report. In addition to the above, Franco also develops a checklist that has to be completed for each item requiring a report, though several items could be included on the same checklist. The checklist includes the following points:

- Item/s on variance list being reported on
- Other reports and investigations undertaken in preparing this report
- Explanation for variation/s
- Corrective action or contingency plans implemented
- Monitoring process for effectiveness of corrective action/contingency plans
- Report dates for advising on progress

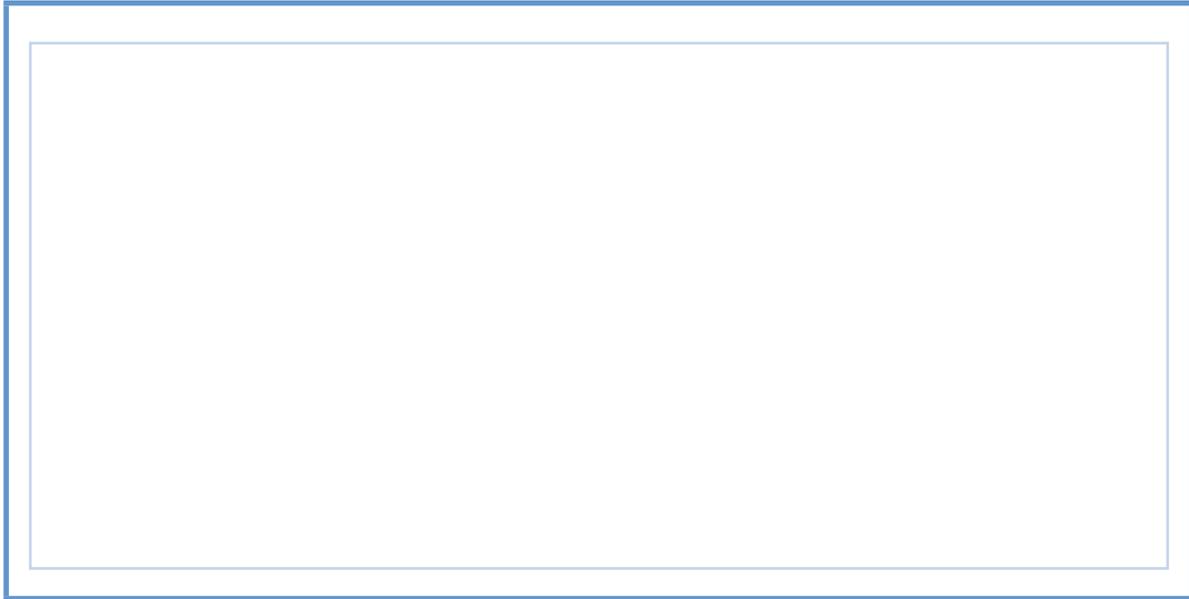


Practice task 11

Provide some guidelines for preparing a report in relation to budget and expenditure.

continued ...

... continued



Summary

1. In order to monitor actual expenditure the various cost items need to be classified as direct materials costs, direct labour costs, overheads and fixed and variable costs, and allocated an appropriate cost code corresponding to the chart of accounts.
2. Actual expenditure is monitored to control costs for future periods.
3. Financial performance is reported by comparing budget income and expenditure against actual income and expenditure at defined times, usually monthly.
4. Variance reports can be generated for each cost centre so that managers can monitor their performance on income and expenditure in each cost category.
5. Contingency plans that form part of the budget development process may need to be implemented during the financial year in order to control expenditure or support sales.
6. Implemented contingency plans should be reviewed, monitored and adjusted in order that the team/organisation achieves the financial objectives.
7. Budget and expenditure should be appropriately documented in line with organisation requirements as a record and for input into the decision-making processes of the organisation.

Learning checkpoint 3

Monitor and control finances

This learning checkpoint allows you to review your skills and knowledge in monitoring and controlling finances.

Part A

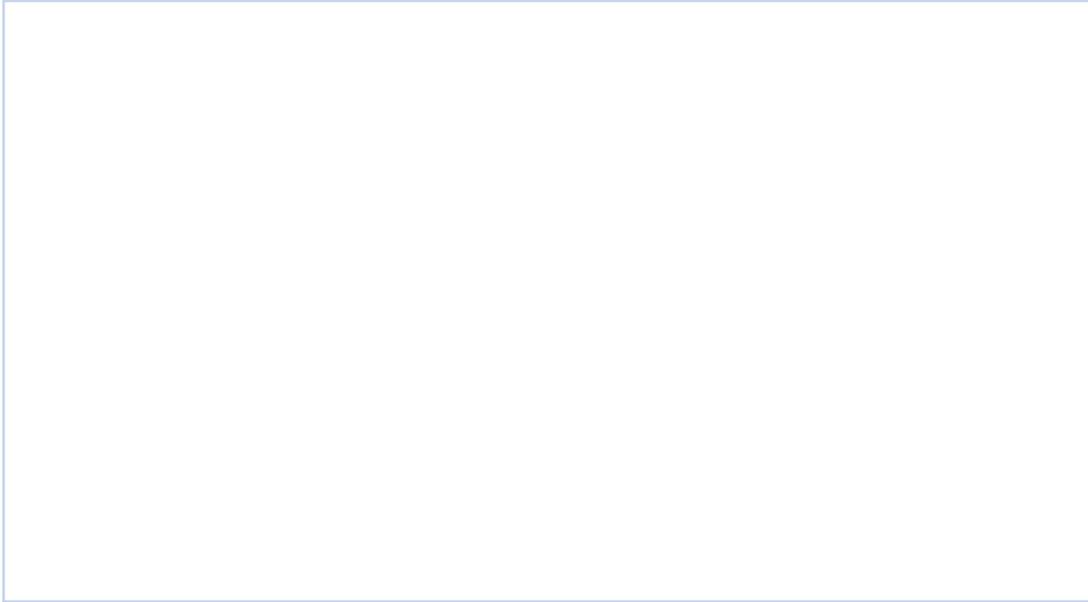
1. Research an organisation or department and describe the range of cost elements it has. Give examples and comment on how the actual costs are recorded or determined.



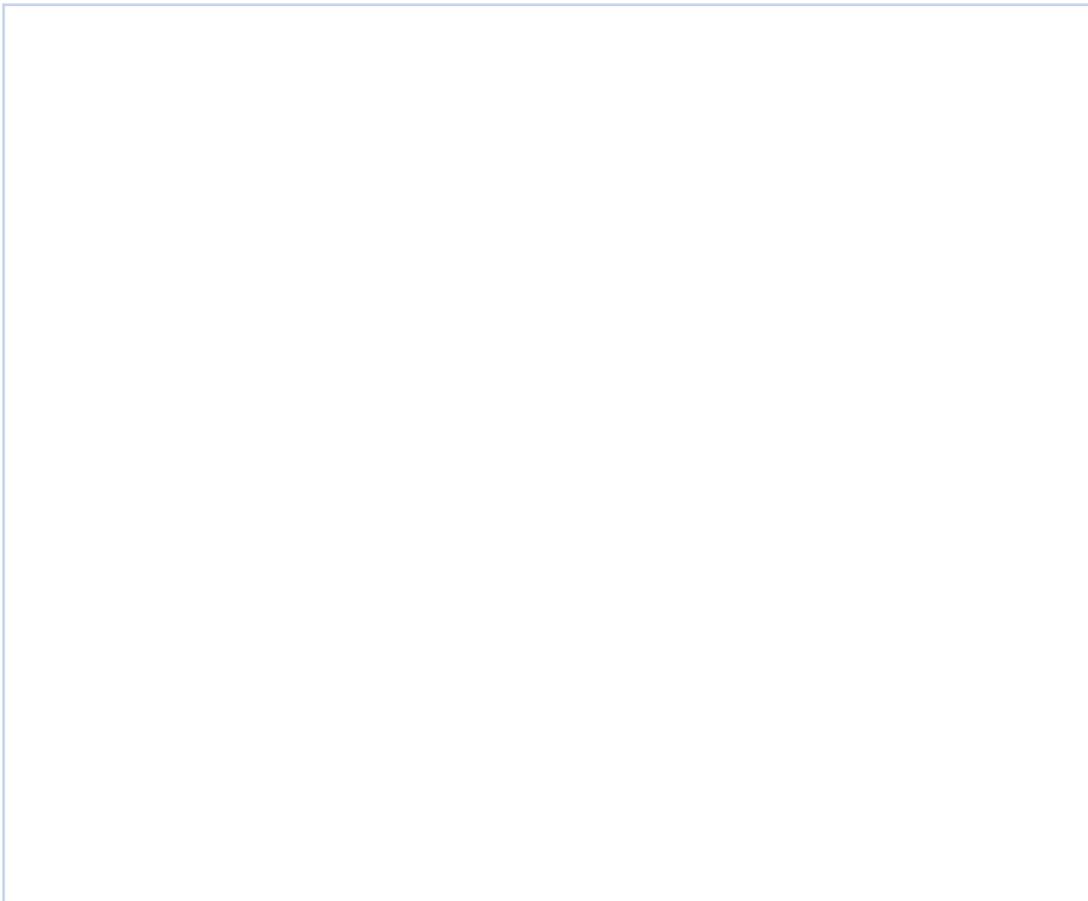
2. Describe the key steps a manager should take to monitor and control expenditure.

3. Describe the reasons for producing a variance report.

4. If sales figures and income are ahead of budget on the variance report, why might a cost centre manager be concerned?



5. Describe the range of financial reports an organisation needs to prepare to manage finances. Select one and describe its purpose, target audience and the outcome of producing the report.



6. Describe a range of circumstances in which a contingency plan for financial planning might be implemented.

7. What is the purpose of monitoring the implementation of a contingency plan?

Part B

Read the case study, then complete the tasks that follow.

Case study

Brendon was made responsible for a new area in the company and the single product it was to produce. He keeps various records on the quantities of the new product his firm produces and the direct labour and direct material costs. It is a simple product in that there is only one raw material and labour.

The budget details are below.

| | |
|--------------------------------|--------------------------------------|
| Planned production: | 5,000 units |
| Direct material cost per unit: | 12 kg at \$6.50 per kg = \$78 |
| Direct labour cost per unit: | 10 hours at \$21.00 per hour = \$210 |

The actual quantities produced and amounts used are as follows.

| | |
|--------------------------------|---|
| Units produced: | 5,200 units |
| Direct material cost per unit: | 9,280 kg at a total cost of \$385,320 |
| Direct labour paid: | 53,040 hours at a total cost of \$1,113,840 |

1. Brendon has asked you to devise a performance report for this department and the single product it produces based on the records he has kept. Determine the actual direct labour cost and direct material cost per unit produced and compare these against the budgeted amounts. Present as a spreadsheet. Suggest reasons for any variances from the budgeted amounts.

2. Should Brendon have advised his supervisor of any cost issues during the production period? If so, what?

3. Brendon does not seem to have any contingency plans in place. In what areas would you consider Brendon should develop contingency plans and for what potential circumstances?

4. If Brendon were to discover that, in the next production period, the costs of the raw materials had increased by 10 per cent, what specific contingency plan or plans might be implemented, assuming that he cannot increase the sale price to counter the increased material cost.

Topic 4

Review and evaluate financial management processes

The activities of an organisation must be documented to provide a record of the operation of the business. The data and records kept are analysed to monitor, control and determine the performance and effectiveness of the systems the organisation has in place. Records are also kept in accordance with legislative requirements and can be used to reconcile various accounts, investigate anomalies, provide information to regulatory bodies and provide evidence at audit time. Processes must continue to be reviewed and analysed for an organisation to remain competitive and profitable. Improvements to existing processes need to be identified, implemented and monitored to ensure the organisation continues to achieve its financial objectives.

In this topic you will learn how to:

- 4A Collect and collate data for analysis
- 4B Identify the effectiveness of financial management processes
- 4C Implement and monitor agreed improvements

4A

Collect and collate data for analysis

A key responsibility of an organisation is to ensure that data from its activities is systematically collected, analysed and recorded in order to assess the effectiveness and efficiency of the organisation's financial management plans and processes.

The data and information gathered must be accurate. Incorrect data or information can lead to poor plans, incorrect outcomes from analysis and consequently wrong corrective actions.

Organisations vary, so the size and nature of the organisation and the business it undertakes is reflected in the structure of the accounts, the chart of accounts, the type of records generated, the collection and collation of data and information and the extent of the records management system.

The information and subsequent analysis of performance and outcomes is used to develop:

- variance reports of actual income and expenditure against budget
- performance reports and recommended actions to be taken
- future strategic plans
- future financial management plans and budgets.

Gather and collate data and information

The objective of collecting the data is to consider how well the financial management processes are working; for example, are budgets always met; are the budgets helping the organisation achieve its objectives; are contingency plans effective when put into action; is the organisation making a profit? Further analysis highlights what aspects are successful and where improvements need to be made; for example, staffing, suppliers, tender processes, outsourcing and managing waste.

Data collection and collation needs to be systematic, so make sure there is a procedure or system for collecting, storing and extracting the various records and information you need.

When data and information is collected it is important that the data is appropriately collated to accurately reflect the actual situation and to eliminate or reduce possible distortions of the data and information. Some examples of possible sources of data distortion and the required actions during collation to minimise these issues are outlined below.

Timing

When collecting data from various departments ensure that the timing is correct for collation and analysis; for example, if some departments have items that fall either side of the end of the month, then decide whether those that fall on the first few days of a month should be included in the previous month.

Location can also impact timing where some areas are physically remote from the main operations of a business.

Currency issues

When items are purchased in foreign currency it is important to use the correct conversion rate so as not to influence the data. This can also be an issue for an organisation operating in different countries; the collation of the data needs to take this into account.

Different systems

Many organisations have various systems that contribute to the data and information that is collected; for example, payroll data for each department will need to be collated with purchasing data in order to provide a complete picture of each department.

Multiple entities

Ensure that all sub-departments have had the relevant data collected so that it can be collated to accurately reflect the whole department.

Types of records and source documents

There is a range of documents you need to access in order to monitor the effectiveness of the organisation's financial management processes. These records may be paperbased or electronic, or a combination of both.

The data and information in the following records relate to various line items in budgets and financial plans of the cost centre in the organisation. Consider the format in which the data is presented and how you can access these records.

Bank account records

Bank account records contain details on deposits, withdrawals and any charges levied. Deposits should correspond to payments and income, withdrawals to cheques or payments that have been duly authorised; charges levied relate to overheads. Bank account records should be reconciled against the organisation's records to confirm they are accurate.

Cashflow data

Cashflow refers to the incomings and outgoings of cash for an organisation. Past cashflow positions can be found by looking at the account balance of the cash book (account). The present balance of the cash book is what is available in cash (or is owed if it is in deficit). Future cashflows are determined by the expected timing of income and expenditure. Where a negative cashflow position is likely, additional cash may need to be borrowed or an overdraft facility put in place. If an excessive positive cashflow position exists then an opportunity may be available for investing funds.

continued ...

... continued

Contracts

Contracts between an organisation and buyers or suppliers contain financial information relating to rates of charges, discounts that might apply, time periods for payments and so on. Such arrangements vary with different parties and therefore the amounts charged and/or amounts paid need to be checked against the relevant accounts and other documentation.

Credit card receipts

A credit card receipting system for payments is generally linked to a nominated bank account. Lists of credit card payments can be reconciled against invoices. Credit card fees charged by the bank can also be checked and recorded in the relevant account.

Income and expenditure

Income arises from goods and services sold, rent, interest or investment income received and possibly the sale of assets, which is sometimes classified as an 'extraordinary item'.

Expenditure is outgoings such as salary and wages, payments for materials and services, payments of overheads; for example, insurance or rent. Expenditure can also be investments; for example, buying shares or a term deposit.

The structure of the accounts need to be such that it accurately reflects the business of the organisation, and that relevant accounts are in place to track the various types of income and expenditure against the appropriate cost centres. Source documentation should be available to verify the various entries into different accounts.

Insurance reports

The amounts stated on insurance reports (either the payment, premiums or receipt on an insurance claim) need to be checked against monies paid or received from the relevant accounts.

Invoices

Invoices are a record of goods and services purchased from suppliers or sold to customers, and correspond to monies that are paid out or received. Invoices for goods or services received and monies paid out should be matched in the accounts payable ledger. Invoices for goods and services supplied and monies received should be matched in the accounts receivable ledger.

Job costing

A job costing documents the cost of direct materials, direct labour and overheads for a specific job. The overheads are calculated according to a formula or procedure. Job costings are used to develop invoices on completion of the job and therefore have a direct impact on appropriate invoicing. A job incorrectly costed implies incorrect invoicing.

continued ...

... continued

Petty cash receipts

Receipts submitted for petty cash claims are a record of expenditure and should be recorded on the accounting system against the relevant area and cost code.

Quotations

Quotations are a potential contract in which the cost of the products and services to be supplied is stated to a potential buyer. When the goods and services are accepted and delivered, the quoted fees apply and these need to be recorded in the relevant accounts.

Taxation records

Taxation records contain information on amounts submitted to the Australian Taxation Office such as PAYG Withholding deductions and GST collected and/or paid (input credits). These details are included in the Business Activity Statements lodged with the Australian Taxation Office.

Payroll

Employee time sheets are a record of the hours worked by an employee and therefore constitute the source document for the calculation of the hours worked, including overtime, penalty rates and any allowances if they apply. Time sheets are a record of the labour; the labour may be for a specific job or it could be for several jobs. Details are recorded on job cost sheets.

Wages are determined from time sheets using hours worked and rates of pay, and salary is determined by terms of employment; for example, annual salary and employment agreement/award or contract. Allowances and deductions are also recorded. These are legislative deductions such as PAYG Withholding and voluntary deductions such as union fees. Superannuation contributions from the employer based on the gross income and paid to designated superannuation funds should also be detailed, and forms part of overheads for the relevant cost centres and/or organisation.

Example: collect and check data and information

Leoni works as part of the financial services department for a wholesaling business. Each fortnight or monthly, where appropriate, it is her responsibility to ensure that the following records are checked.

- Time sheets for casual and part-time workers in hard copy against payment made via payroll.
- Substantiation documentation against allowance claims for travelling sales representatives.
- Credit card receipts submitted by the employee with the credit card against the monthly statement.

Any missing documentation is requested from the relevant personnel. In each case she also looks to see that the appropriate authorisations have been obtained by checking signatures. Once the various documents have been checked and reconciled Leoni has to file them in accordance with the company policy and procedures. In the event that there is an inconsistency, Leoni refers the matter to her supervisor for investigation.

Practice task 12

State three types of records that an organisation should keep to monitor its financial performance. Explain why each is important.



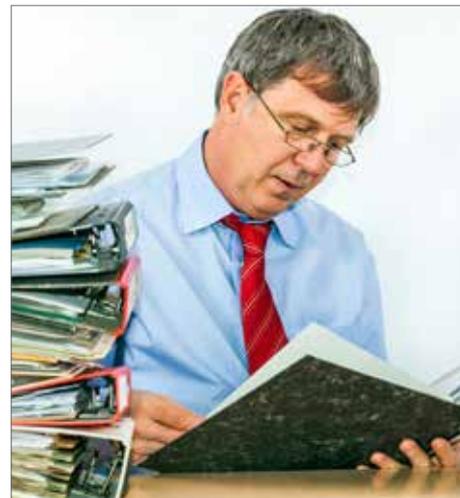
4B

Identify the effectiveness of financial management processes

Successful financial management is dependent upon the ability to monitor and control the management of the finances and ensure financial resources are used effectively. Performance in terms of financial management is identified by comparing outcomes against the targets and KPIs that were set as part of the development of the financial plans and the associated budgets. When a budget period shows the team is underperforming, then the manager needs to analyse the documents and reports and discuss the situation with team members to identify areas where they need to improve.

The manager must ensure they:

- prepare accurate budget development and cost estimates each budget development period
- record all financial data accurately
- analyse source data and information accurately
- instigate a timely reporting system
- respond promptly to reports showing unfavourable variations
- ensure estimates of quotes, hours and job costs are realistic
- implement a well-maintained knowledge management system to ensure records are maintained and stored securely.



Analyse the data

The type of financial reports generated through the qualitative and quantitative analysis of data and information varies substantially between and within organisations due to their size, structure and the nature of their business; for example, a report or analysis provided to a manager responsible for a project with a budget of \$100,000 and a staff of two is very different to a person responsible for a service department with 77 staff and a budgeted turnover of \$5.7 million. The level of analysis performed and the level of detail in reports also varies.

In analysing source documents and reports, look to see whether you have managed the financial resources allocated to you and your team successfully in accordance with the budget plans and in keeping with organisational policies and procedures. This means checking to see whether the team has been able to meet its budget and, if not, analysing the source documents to identify circumstances that have accounted for cost variations and expenditure overruns in the budget, or errors or inaccuracies in documents that have led to incorrect conclusions and reporting.

You may like to refer to the Australian Standard and International Standard in its entirety on records management. It outlines the policies and procedures that should be followed to ensure records are created, managed and preserved efficiently and effectively. Organisations and libraries should have a copy, or the Standard can be purchased: *AS ISO 15489:2004 Records Management*.

Peter Drucker published widely in the area of management and the use of performance indicators. This book provides an overview of both financial and non-financial performance indicators that can be used towards reviewing and evaluating financial management processes.

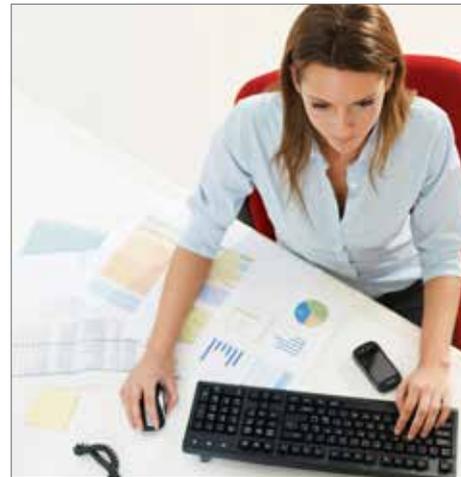
Drucker, PF 2007, *The practice of management*, Harvard Business School Press, Boston, USA.

Analyse the budget variations

You need to look at the range of documents associated with financial management, but the first one is your budget. Check to see whether there are unfavourable variations. You then need to check the corresponding documentation to see where the variations occur and what caused them.

Variations between actual and budget undoubtedly occur. The variations may be measured as a percentage variation and as an actual amount.

It is good practice to report on the reason for budget variances. Many budget managers are expected to provide an explanation as to why variances are occurring and the actions being taken to address expenditure overruns. The amount of variation and the percentage of variation requiring investigation and reporting is often a policy set by the organisation itself. When variations are detected the first investigation is to look at the source documentation.



Managing budgets requires the management of work teams. This short book is a good overview on team management: Heller, R 1999, *Managing teams*, Dorling Kindersley, London.

The balanced scorecard approach provides an insight into a range of performance measures that an organisation can use. You may like to read more about this in the following book:

Kaplan, RS & Norton, DP 1996, *The balanced scorecard: translating strategy into action*, Harvard Business School Press, Boston, USA.

Example: analysis of a budget report for a 6-month period

| Budget item | Budget amount | Actual expenditure | Variance (\$) | Variance (%) |
|-------------|---------------|--------------------|---------------|--------------|
| Stationery | 500 | 600 | 100 | 20.0 |
| Wages | 160,000 | 164,000 | 4,000 | 2.5 |

The current overspend on stationery, though 20 per cent, will not have a significant impact at the end of the year but should be checked. Possible explanations and comments on the budget report could include the following:

- A double order of paper was placed this last month to take advantage of a supply special
- Two new staplers that were not budgeted for were purchased to replace broken equipment

continued ...

... continued

For the salary and wages the variance is 2.5 per cent, which in the bigger picture is not a high variance but at the end of the year could represent an \$8,000 overspend. Possible explanations and comments on the budget report could include:

- Some additional casual hours have been used to cater for illness over the last two months and casual hours will be reduced to address the budget position.
- An additional large order for our key product was received and additional labour used to meet the required dispatch date. The additional wages are covered by the additional income received.

With respect to budget variances, if five per cent variation was the critical value requiring investigation, the wages issue would not get a comment. If, however, the actual expenditure on wages was \$184,000, corresponding to \$24,000 or 15 per cent overspend, an investigation into this would be required and reported to the supervisor as part of the financial management process.

Check source documents

Where an analysis suggests there are variations from the budget that are unexpected, it is important to consider the source data and information that has been used to generate that report. Drilling down into the data to verify the position that is being reported can confirm or reject the report itself or provide information that might explain the reasons for the variation.

When discrepancies are found, corrective action is required to improve the analysis and reporting. Errors or reporting inaccuracies that may be identified through analysing source documentation are shown below.

Incorrect data entry such as:

- incorrect coding of the expenditure to the chart of accounts (for example, against the stationery code instead of equipment code)
- incorrect recording of the purchasing department for expenditure (for example, marketing department code entered instead of sales department code)
- typing errors; for example, 405 hours labour instead of 40.5
- incomplete or repeated input; for example, items not included on the system or entered twice.

Incomplete or incorrect source documentation used and not questioned such as:

- incorrect hours recorded on an employee's time sheet or hours incorrectly calculated
- incorrect calculation on documentation; for example, GST amount not charged or incorrectly calculated
- materials used and associated costs not calculated correctly.

Example: identify errors

A data entry error occurred when an insurance premium of \$1,500 had been paid and the entry into the accounting system was recorded as \$15,000. Such an error should be picked up when reconciling accounts but in this case, before that had happened, the cost centre manager received a variations report suggesting that his budget for insurance had been overspent for the year by over 500 per cent.

Circumstances responsible for budget variations

If current data is not entered on the system in a timely manner, you may find a report is based on out-of-date information that consequently provides an inaccurate picture. If actual expenditure is lagging as a result of slow data entry then expenditure shown on the end-of-month report may appear to be better (less) than it really is. Similarly if all the income received is not entered in time for the running of the end-of-month variance reports for a cost centre, the picture appears worse than it should be.

Source documentation can also provide an insight into circumstances that have changed and that directly impact on the budget as shown below.

Source documentation may assist with identifying reasons for budget variations

1**Standing orders**

Standing orders such as the weekly supply of inputs often occur without weekly approval and cost increases in these inputs may not have been brought to the manager's attention.

2**Job costings**

Incorrectly estimated job costings resulting in cost overruns and lower-than-appropriate charges to customers.

3**Labour costs**

Changes in labour costs due to changes in personnel, resulting in variations to salary and wages that are different to the budgeted amounts.

4**Cost of supplies**

Increases in the cost of supplies due to price rises from the supplier.

5**Overtime costs**

Increased overtime costs that can be attributable to absences due to illness or increased demand for products and services.

6**Data processing**

Delayed processing of source data onto the financial system resulting in incorrect reports.

Example: the impact of entering GST incorrectly

The billing sheet for a person charging a job was GST-inclusive. Labour and all items used in a job were GST-inclusive and the amounts were duly added to provide a total inclusive of GST. When completing the GST amount at the bottom of the form one employee was dividing the total by 10 instead of 11. So for a job inclusive of GST totalling \$2,200 he was reporting a GST on it of \$220 rather than \$200, and thus the GST report would not balance on the monthly reports. The employee was advised of his error and the documentation adjusted to indicate that the figure must be divided by 11 and not 10.



Recommend improvements

Once you have analysed the data and reporting mechanisms you should be able to identify where improvements need to be made. You need to discuss any proposed improvements with those team members who have responsibility for financial tasks.

The financial management process begins with the preparation of budgets. The better the data, information and reports provided at the start, the greater the potential for accurate budgets that achieve the team's (and organisational) objectives.

If performance reports are deficient in some manner, you need to consider options for improving the reports. Here are some options for improving reporting that you could consider.

Modify a report

Modify a report by including additional information, deleting unnecessary or redundant information or adjusting the presentation and format.

Adjust the timing of reports

Adjust the timing of reports by providing them at more appropriate time slots to suit managers or more frequently; for example, fortnightly rather than monthly for earlier recognition of potential issues.

Adjust the distribution of reports

Adjust the distribution of reports to ensure additional personnel are included initially so they can consider actions that might be required; for example, providing a copy to the budget manager of a cost centre at the same time it is provided to the cost centre manager can mean that the reports are being considered several days earlier, rather than waiting for the cost centre manager to hand them on.

continued ...

... continued

Prepare additional or alternative reports

Prepare additional or alternative reports to focus on specific reporting requirements for budget managers and as a comparison with existing reports. This can be more than simply modifying a report and may require programming of the report generator in the accounting and finance system or additional resources to gather the source data and information to generate the report.

Improve the carrying out of financial tasks

Members of teams involved with budgets and financial plans often have designated responsibilities in terms of operations and reporting, such as invoicing (accounts receivable), payments (accounts payable), purchasing (supply), salary and wages, compliance and reporting (GST) or debt collecting.

Where team members have such responsibilities they need to look for improvements in the way the processes operate, especially if there are errors in reporting or inaccuracies in calculations, as well as how they record and report financial information. Timely receipt of data and information is critical, and contributes to the accuracy of the reports they produce and the analyses they undertake. Greater frequency in reporting often identifies potential issues early.

You may need to arrange further training in how to maintain journals and ledgers accurately, or information sessions to bring team members up to date with current legislation or best practices.

Example: detect variations and problems early

Henri manages a team of five people responsible for managing and reporting on budgets for an organisation with 130 employees. Quarterly reports are produced for analysis across a wide range of areas for comparison against the targets and KPIs that have been set. At the end of the third quarter the analysis of the reports indicates that the expenditure for the business is 10 per cent over budget and that the income is 7.5 per cent below expectation. Henri and his team have to determine how this situation has arisen and provide recommendations on action for the remainder of the year.

The analysis reveals that the reports produced at the end of the second quarter have not included some significant expenditure, and that the third quarter has an additional fortnightly pay run included in the expenditure. A payment in advance from a major buyer was processed late in the second quarter and attributed to the second-quarter income. The net result is that the reports at the end of the second quarter have suggested that the organisation is on track according to the budget but the true picture is different.

It is not possible for the organisation to make up such a significant variation before the end of the financial year, and management takes action to minimise what is ultimately going to be a loss for the year. Contingency monies and reserves need to be allocated to cover some expenditure before the end of the year.



continued ...

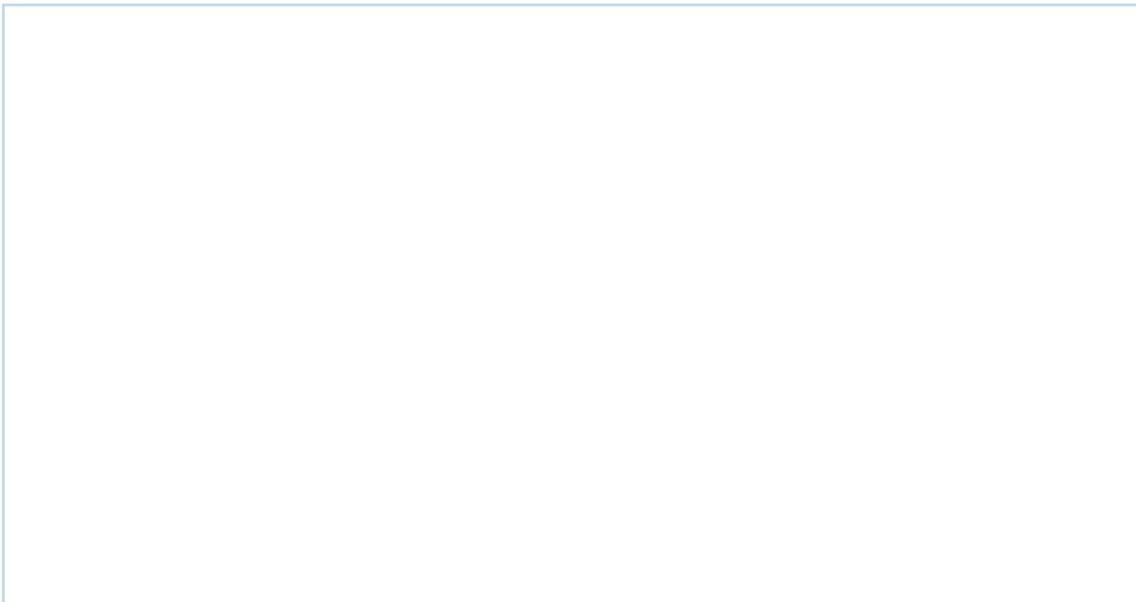
... continued

The main issue for Henri and his team is the infrequency of the reporting and analysis that is being undertaken. If reports had been run at the end of each month the situation would have come to light two months earlier. Consequently, monthly reports are instigated and members of Henri's team have their roles adjusted so that additional time can be spent on the financial management side. Henri finds that more frequent regular monthly monitoring identifies issues earlier and improves financial management, and that insufficient or irregular monitoring and analysis can mask the true position of the organisation, and fail to trigger a need to check and analyse data and information.

As a final improvement, Henri arranges for a consultant to talk to his team about financial reporting.

Practice task 13

Provide a brief overview of a situation where an improvement to the financial management process could be recommended based on the analysis of records and reporting.



4C

Implement and monitor agreed improvements

Any recommended improvements need to be agreed upon and approved by the relevant authorised personnel. Once approved, they should be promptly implemented then regularly monitored to ensure they are improving financial management processes.

The object of any improvement to financial management processes is increased efficiency and effectiveness; for example, by reducing production costs or by increasing volume of manufacturing using the same levels of resources.

Agreed improvements may take significant time to implement; for example, merging two cost centres into one with the aim of gaining efficiencies in administrative support. Net efficiencies may not be observable until the implementation is complete, which could be quite a significant period after the decision was made. Improvements always need to comply with organisational objectives and financial objectives of the work teams, cost centres and the organisation.

Some broad areas for gains in efficiency

- Adjusting product design that requires less resources to produce
- Altering production methods; for example, mechanisation and automation versus human labour
- Streamlining procedures in the delivery of a service
- Considering economic (minimum cost) approaches to managing materials (inventory)
- Managing labour and appropriate policies to determine the type of labour required such as permanent, part-time or contracted
- Managing methods of payment such as productivity-based incentives
- Outsourcing some functions to reduce costs and potential overheads
- Reducing the cost of finance through better use of capital
- Adjusting marketing and promotion methods
- Moving to cheaper packaging and adjusting distribution methods
- Reorganising the structure of the organisation

Implement and monitor improvement

A major change such as a structural reorganisation is generally implemented using a project management approach, with milestones set as part of the project and reports generated regarding the progress on implementation. Major changes in production methods with the purchase and commissioning of significant pieces of equipment are another example of a project approach. For such large and complex improvements a separate project budget may be developed, approved and managed in order to achieve the changes. Less complex changes, such as a change in procedures, may require very little time to implement and, as such, there may be little or no cost associated with the changes.

Here is the process for monitoring the twofold implementation of improvements.

Monitoring implementation

Monitoring the implementation of the improvement itself against defined targets by checking that staff understand their new responsibilities, appropriate physical, human and financial resources are allocated and time lines are met.

Monitoring post improvement

Monitoring the situation after the improvement by obtaining feedback, analysing reports and identifying whether there are any favourable variations between budgeted and actual targets.

Example: improve a process that contributes to an organisation meeting financial objectives

Grace works in the accounts department of a large plumbing business and is responsible for issuing invoices to customers. When the plumbers are out on the road doing jobs for customers, they purchase parts from the nearest plumbing supplies store or hardware store if they do not have the materials on their truck. The plumbers use a company credit card to purchase these materials. The process of tracking the purchases and allocating the costs to the correct job is breaking down and so is the ability to accurately assess the productivity of individual jobs.

Grace suggests that the plumbers should have a simple form that can be used to record the date, place of purchase and job number on a sheet; they attach the docket from the supplier. These sheets are to be given to Grace on the last day of each week when the plumbers have to come via the office to collect the job details and any supplies from stores for the following week. The senior manager discusses the proposal with the plumbers and supervisors and it is agreed.

Grace is now able to provide accurate invoices to the customers and accurate reports on the profitability of each job.

Example: improve timing of expenditure reports

Martina is the head of the finance department of a company that provides IT consultancy services and systems installations. She is frustrated that the paperwork from the consultants on expenses being incurred is constantly late. The current process is for consultants out at sites to use their own resources to purchase needed items on site and complete paperwork as an expense claim later.

Martina's target is to have the relevant reports compiled and distributed not more than eight working days after the end of the month. The reports being generated are not accurate as they do not contain all expenditure for the preceding month, because consultants are not sending it in on time and often have difficulty as they are interstate.

On discussing the situation with the general manager and with the consultants, it is agreed that each consultant is issued with a corporate credit card so that the expenses can be recorded on the credit card statement, and therefore taken into account when producing the monthly performance reports.



Practice task 14

Write a report on a situation in a business where improvements to the financial management process and reporting could be needed. Ensure you address the following in your report:

- An outline of the area that needed improving, and why and how the matter was raised
- The process for obtaining agreement for the implementation of a recommended change
- The implementation process
- The monitoring process for the implemented improvement
- The outcome
- What records were kept

The report should not be more than one-and-a-half pages. Attach samples of the reports or documents that are relevant to the situation you have outlined.



Summary

1. A key responsibility of an organisation is to ensure that data from its activities is systematically collected, analysed and recorded, in order to assess the effectiveness and efficiency of the organisation's financial management plans and processes.
2. Timely collection and collation of data and information is a critical function for an organisation if it is to produce accurate reports.
3. Data and information gathering needs to be accurate, reliable, free from errors and be presented in accordance with designated time frames.
4. Source documentation should be reconciled against the various accounts to verify accuracy of data and information on the system.
5. Reports are the basis on which budgets are developed for the future, so incorrect reports or analysis lead to inaccurate budgets that may not deliver on the objectives of the work team or organisation.
6. Performance reports on the effectiveness of the financial management processes should be analysed, with changes identified that can improve the reporting options and existing processes.
7. Recommended improvements need to be approved, implemented and monitored to ensure that improvements to financial management processes are effective and assist the team to achieve its financial objectives.

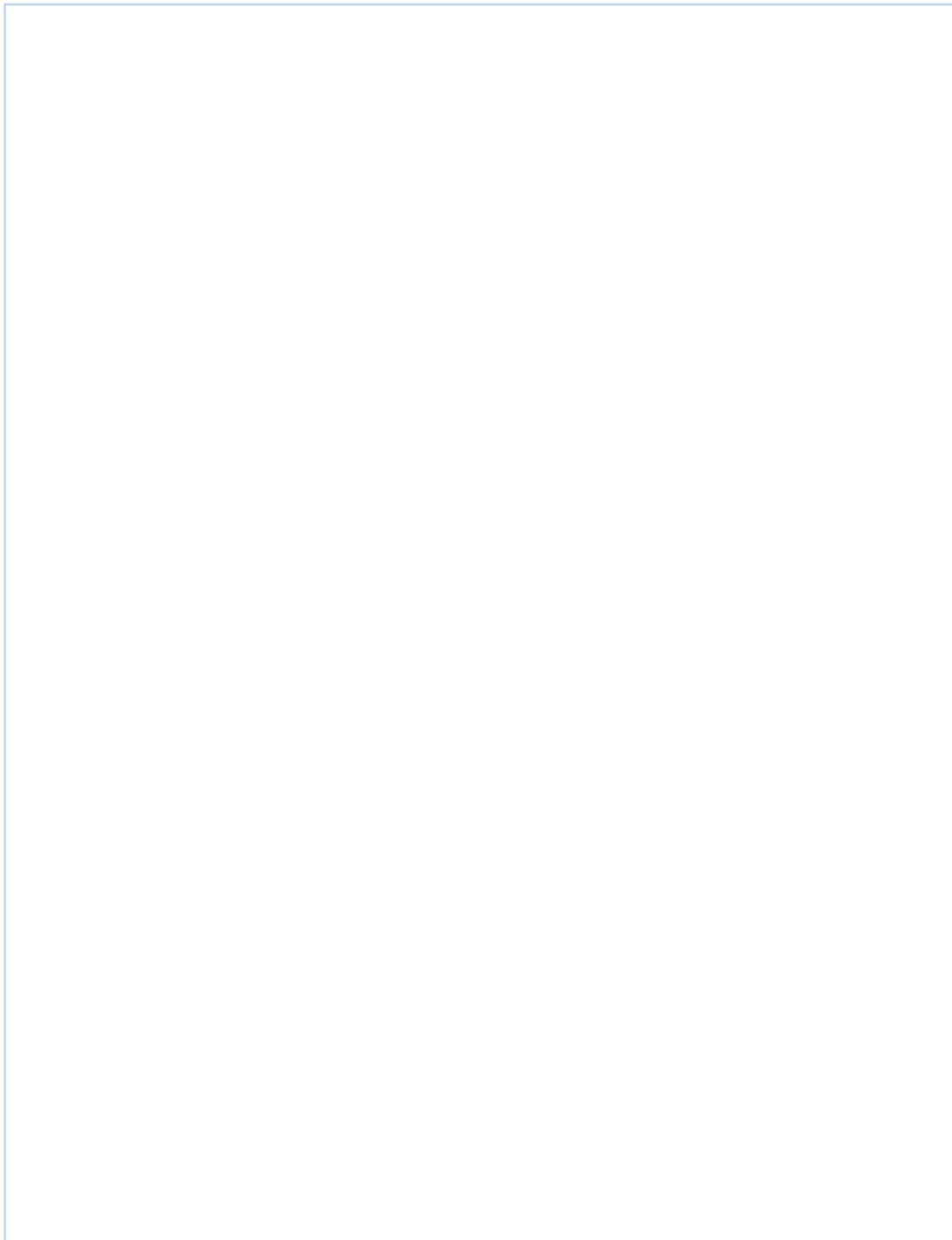
Learning checkpoint 4

Review and evaluate financial management processes

This learning checkpoint allows you to review your skills and knowledge in reviewing and evaluating financial management processes.

Part A

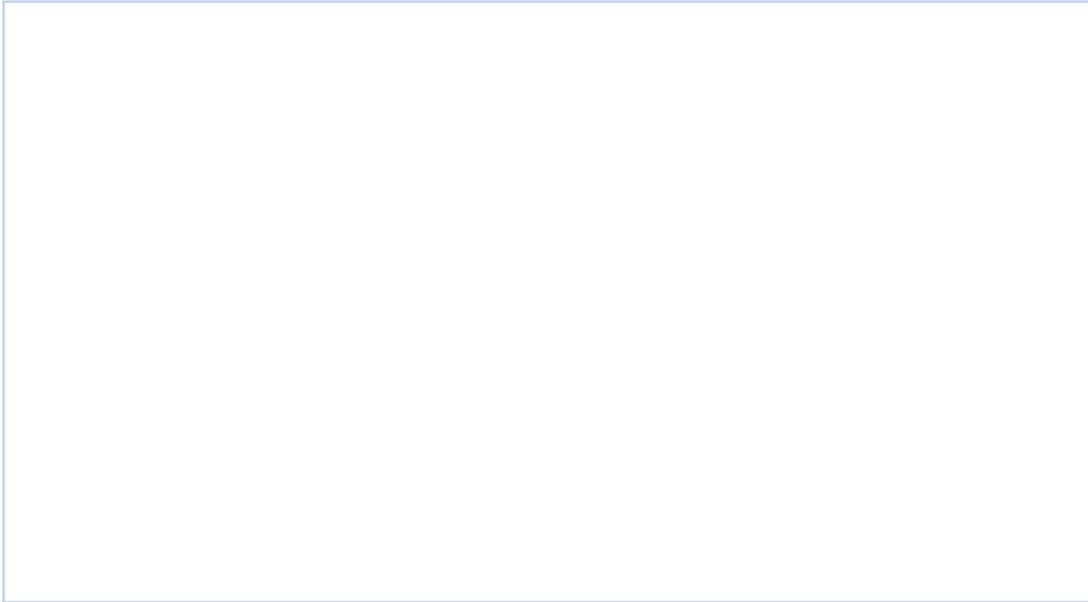
1. What constitutes an effective financial management process? Give examples to illustrate your response, including the skills and knowledge needed by managers.



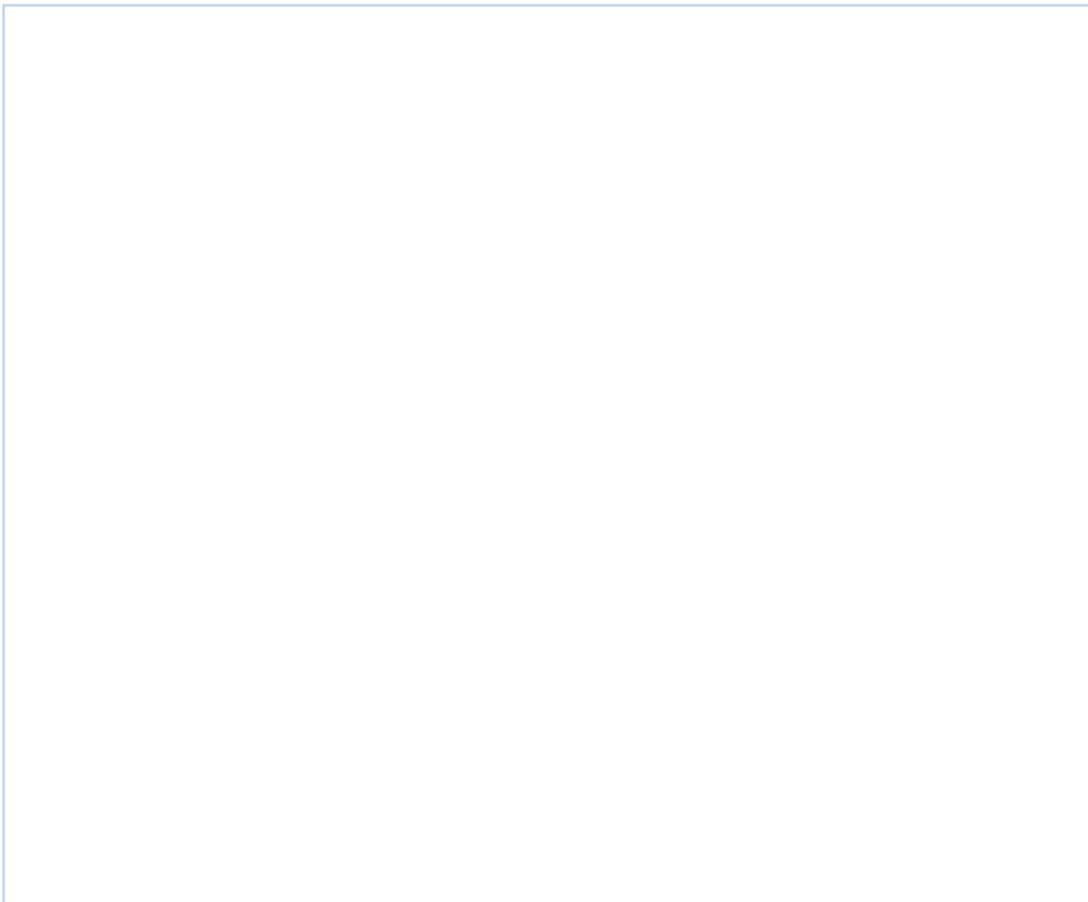
2. List four different financial records and describe the relevance of the information they contain in terms of managing financial processes.



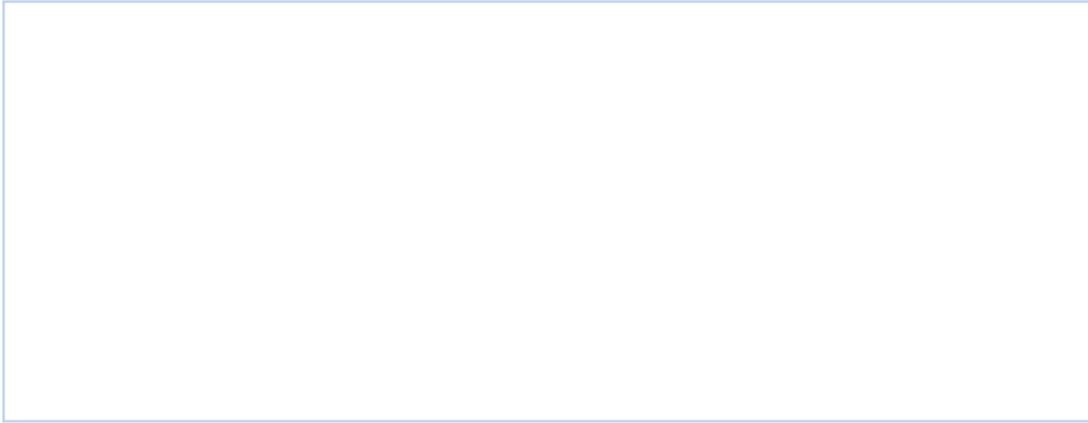
3. What is the purpose of preparing financial performance reports?



4. How can a person verify the accuracy of a financial management report? Provide an example.



5. Explain why timing is crucial when preparing financial reports.



6. Describe an example of an improvement that could be made to a financial management process that you are familiar with.



Part B

Read the case study, then complete the tasks that follow.

Case study

Mike is the budget manager for a consultancy firm that operates Australia-wide. It provides services in relation to hazardous materials and protection of the environment.

Mike has a team of people spread across the country operating in each of the offices. His team members are responsible for all aspects of expenditure in each of the offices and the processing of any documentation relating to material purchase, equipment purchase (such as air sampling devices or chemicals of sample testing), salary/wages and processing of hours worked, allowances etc., and payment for other inputs such as expert advice when required such as legal advice.

When running various company reports at the end of the month Mike notices that the profit margin is smaller than usual and that, on investigation, the offices in Perth and Adelaide are primarily responsible with actual expenditure above the budget. The main cost in Perth appears to be in salary/wages and overheads; in Adelaide the cost overrun appears under consumable chemicals equipment and travel.

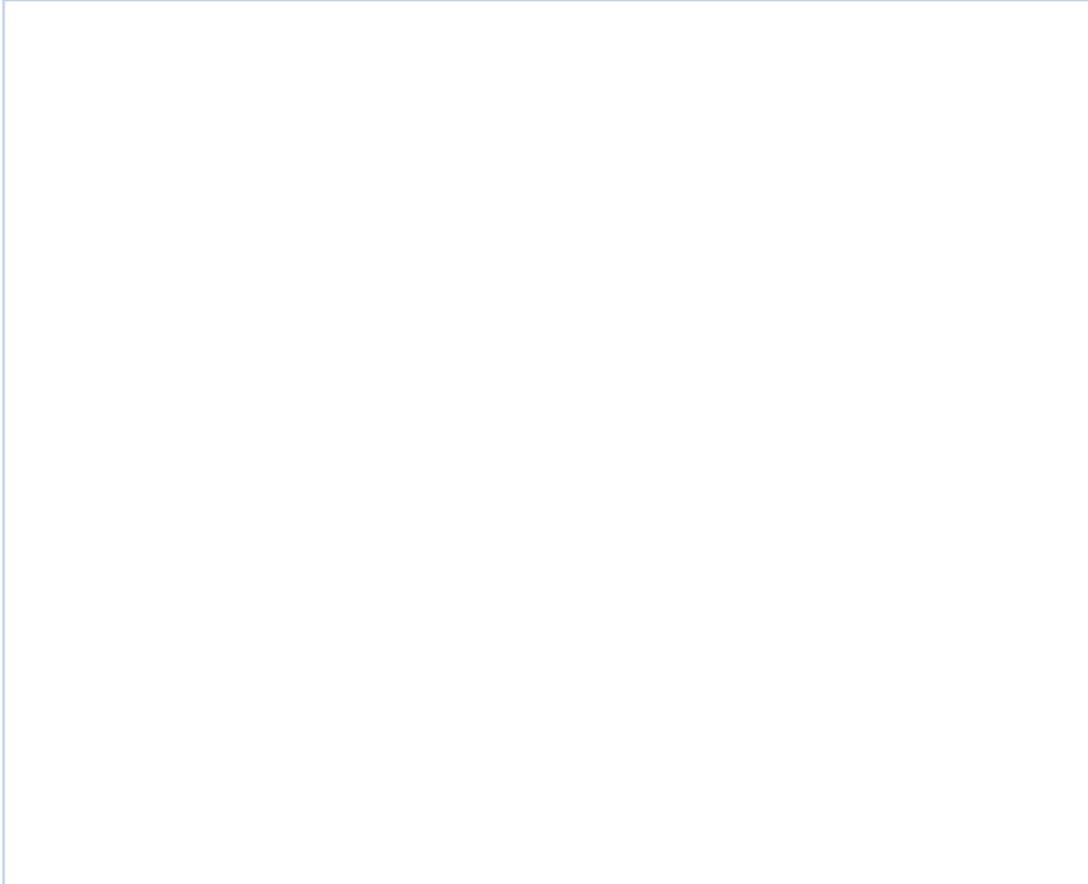
An investigation by his team members results in the following conclusions.

| Perth | Analysis and areas for improvement |
|---|--|
| <p>Some errors have been made in processing time sheets with data entry, especially by new staff.</p> <p>The average salary in Perth for consultants and scientific staff doing sample analysis is high.</p> <p>Lease payments for the building they occupy have increased as well.</p> | <p>The incorrect data entry is to be addressed by additional training.</p> <p>The salary increase is still an issue but documentation is provided showing that some staff have been awarded an increase to keep their services, as a competitor was offering higher pay. Higher salaries were also introduced to attract some key analysts from Sydney and Melbourne. The expectation is that this will be an ongoing issue.</p> |

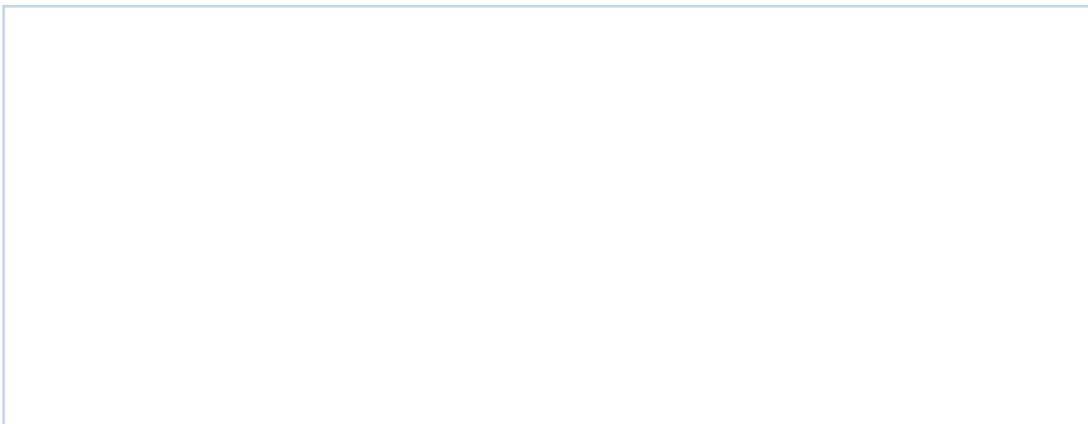
| Adelaide | Analysis and areas for improvement |
|--|--|
| <p>Significant car travel has been incurred with staff driving to the mine site and development sites in the centre of the state.</p> <p>New equipment has been purchased in excess of the budgeted items.</p> <p>Additional chemicals have been purchased but there are concerns that the purchasing process has resulted in incorrect orders and wrong quantities being ordered.</p> | <p>There appears to be clear errors in the procedure for purchasing and also in the method of collecting, processing and storing of some source documentation/records. Similarly, the record keeping and justification of travel expenses is not consistent. Staff need training in these areas.</p> <p>The team is going to consider teleconferencing to reduce travel.</p> |

1. List the contingencies that Mike could put in place to reduce cost overruns.

2. a) Draft a procedure (include a checklist if this is appropriate) to process documentation for data entry into the finance system for each of the following:
 - Salary and wages
 - Travel claims using an employee's own vehicle
 - Ordering equipment
 - Storage of source documentation including time frames for storing the records



b) Explain why having these procedures improves financial management.



3. Suggest procedures or initiatives that could enable Mike to improve his financial management.

