

**BSBFIN501**

**MANAGE  
BUDGETS  
AND  
FINANCIAL  
PLANS**

# **BSBFIN501**

## **Manage budgets and financial plans**

Release 1

## **Learner Guide**

Aspire Version 1.1



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BSBFIN501 Manage budgets and financial plans, Release 1

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First published October 2020

Cover design: Anne-Marie Reeves Design  
Printer: Doculink Australia Pty Ltd, 1d/28 Rogers Street, Port Melbourne VIC 3207

e-ISBN 978-1-76075-665-9 (PDF version)  
ISBN 978-1-76075-664-2

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## Before you begin

This Learner Guide is based on the unit of competency *BSBFIN501 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](http://www.training.gov.au).

### How to work through this Learner Guide

This Learner Guide contains a number of features that will assist you in your learning. Your trainer will advise which parts of the Learner Guide you need to read, and which Practice Tasks and Learning Checkpoints you need to complete. The features of this Learner Guide are detailed in the following table.

Feature of the Learner Guide	How you can use each feature
Learning content	Read each topic in this Learner Guide. If you come across content that is confusing, make a note and discuss it with your trainer. Your trainer is in the best position to offer assistance. It is very important that you take on some of the responsibility for the learning you will undertake.
Examples	These highlight key learning points and provide realistic examples of workplace situations.
Practice Tasks	Practice Tasks give you the opportunity to put your skills and knowledge into action. Your trainer will tell you which practice tasks to complete.
Summaries	Key learning points are provided at the end of each topic.
Learning Checkpoints	There is a Learning Checkpoint at the end of each topic. Your trainer will tell you which Learning Checkpoints to complete. These checkpoints give you an opportunity to check your progress and apply the skills and knowledge you have learnt.

## Foundation skills

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

The following table provides definitions for each foundation skill.

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

## What do you already know?

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

Topic	Key outcome	Rate your confidence in each section
Topic 1: Plan for financial management	1A Access budgets and financial plans	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	1B Assess budgets and financial plans with relevant personnel	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	1C Negotiate changes to budgets and financial plans with relevant personnel	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	1D Prepare for contingencies	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
Topic 2: Implement and monitor financial management plans	2A Communicate budgets and financial plans with team members	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	2B Provide support to team members	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	2C Monitor and control expenditure	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	2D Report on budgets and expenditure	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident

Topic	Key outcome	Rate your confidence in each section
Topic 3: Review and evaluate financial management plans	3A Collect information for analysis	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	3B Analyse variances and recommend improvements	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	3C Implement and evaluate agreed improvements	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident



## Topic 1 | Plan for financial management

- 1A Access budgets and financial plans
- 1B Assess budgets and financial plans with relevant personnel
- 1C Negotiate changes to budgets and financial plans with personnel
- 1D Prepare for contingencies

# 1A Access budgets and financial plans

---

Understanding your organisation's priorities and objectives for the short term and long term, as outlined in the strategic plan, will enable you to understand and manage financial resources.

Organisations vary in the way they present their financial and organisational objectives. Most develop a business plan, a strategic plan and an operational plan, all of which include budgets.

A business plan outlines the future direction for the organisation by forecasting likely revenue and expenditure and setting financial targets. A strategic plan breaks down the business plan and determines the major courses of action, including key resource allocations. Operational plans relate to the day-to-day activities required to achieve the strategic objectives and to measure the organisation's actual financial performance against targets.

The plans that are developed may have short- or long-term timelines ranging from several years to a year, quarter, month or week.

Understanding how these are then translated into organisational and team budgets will best enable you to manage financial resources in line with the financial objectives of the team and organisation.

## Budgets

**A budget provides financial targets or allocations for a set period of time, against which the success of a plan and its parts can be measured.**

Budgets can be set for various parts 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. They should 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 on the following page, 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.

## Specialised budgets

Specialised budgets are ultimately included in the organisational budget, as they form part of the organisation's total financial activity. Their purpose is to reflect one particular activity in greater detail, such as the effect of engaging in a particular activity or owning and maintaining certain assets.

Examples of specialised budgets are shown 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.

### Costs of goods/services sold budget

This budget is developed from the expected cost of goods or services, which 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, which takes into account 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; for example, 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 to manufacture the goods, as well as the finished products or goods held to meet demand from buyers.

### Budgeted profit and loss

A budgeted profit and loss statement summarises expected income and expenses (excluding GST). It is a plan to guide an organisation's operational spending within a specified period. Managers often prepare the profit and loss budget by reviewing previous financial statements and factoring in expected growth or information relating to new items.

### Budgeted balance sheet

A budgeted balance sheet projects the balances of assets and liabilities and guides management decision making. This budget enables managers to check the viability of other budgets by determining whether there will be enough cash to fund organisational activities.

## Cash flow budget

A cash flow budget is a budget that provides an overview of cash inflows (such as customer receipts) and outflows (such as business expenses) during a specified period of time, and includes GST on these inflows and outflows, where applicable. The primary purpose of a cash flow budget is to provide the status of the organisation's cash position at any point in 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.

Most businesses are required to lodge business activity statements (BAS) on a regular basis, such as quarterly or monthly. These BAS amounts will need to be estimated and included, mostly as a cash outflow, in the cash flow budget.

## Obtain budgets and financial plans

You will need to be familiar with where your organisational budgets and financial plans are kept, so they can be easily accessed when needed.

Organisational and team budgets are often developed by senior management and disseminated to team members via their manager for discussion. Operational budgets are usually kept by the manager and shared with team members so they can:

- set relevant targets
- set key performance indicators (KPIs) to be achieved, and
- discuss the team's responsibilities in meeting the budget.

Budgets and financial plans may be available to you in hard copy format. These will be securely stored in a lockable drawer or folder and you may require authorisation to access them.

Budgets and financial plans may also be available in soft copy format. These will be accessible through your organisation's accounting and bookkeeping software, or detailed electronic spreadsheets. You will need to check that you have the required user access to open and download these documents.

It is important that formulas in electronic spreadsheets are checked regularly to ensure there are no errors in formulas and calculations. Electronic spreadsheets should be password protected and effectively use embedded functionality, such as edit permissions, read-only options, hidden or protected worksheets and locked cells, to prevent misuse of data.

Ensure that you are following organisational policies and procedures for accessing, sharing and storing financial plans and budgets at all times. 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.

## Understand budgets and financial plans

It is your job to access, review and understand the different budgets and financial plans so you can explain them to members of your work team.

This will help your team understand the goals and objectives they are expected to achieve and the financial boundaries within which the team must operate.

Below are some definitions and explanations of budgets, plans and projections:

<b>Strategic long-term budgets/plans</b>	<ul style="list-style-type: none"> <li>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.</li> </ul>
<b>Short-term and operational budgets/plans</b>	<ul style="list-style-type: none"> <li>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.</li> <li>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.</li> </ul>
<b>Spreadsheet-based financial projections</b>	<ul style="list-style-type: none"> <li>In developing inputs and parameters for operational and financial budgets, spreadsheet models are often developed to provide a picture of the expected sales and expenditure for various departments within an organisation.</li> <li>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, these projections can be useful in providing guidance on the position of the organisation at some future point in time.</li> </ul>

## 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 and 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.

Each year, Jessica and her team prepare plans and budgets for her office 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
- cash flow 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

### Question 1

---

Draw a line to match each budget to its correct description.

- |                                      |  |
|--------------------------------------|--|
| » Sales/revenue budget               | » Outlines expenses such as travel, advertising and promotion that are related to the sale of the goods and services produced.   |
| » Operating expenses budget          | » Provides an overview of cash inflows and outflows during a specified period of time, and includes GST on these inflows and outflows, where applicable.                         |
| » Budgeted profit and loss statement | » Documents the expected income from the sale of goods and services and all other income sources, such as service fees, investment income, donations (if applicable) and grants. |
| » Cash flow budget                   | » Summarises expected income and expenses (excluding GST) for a specified period of time.  |

### Question 2

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Name three types of organisational plans that a business might use to present their financial and organisational objectives. Include a brief explanation for each plan listed.

### Question 3

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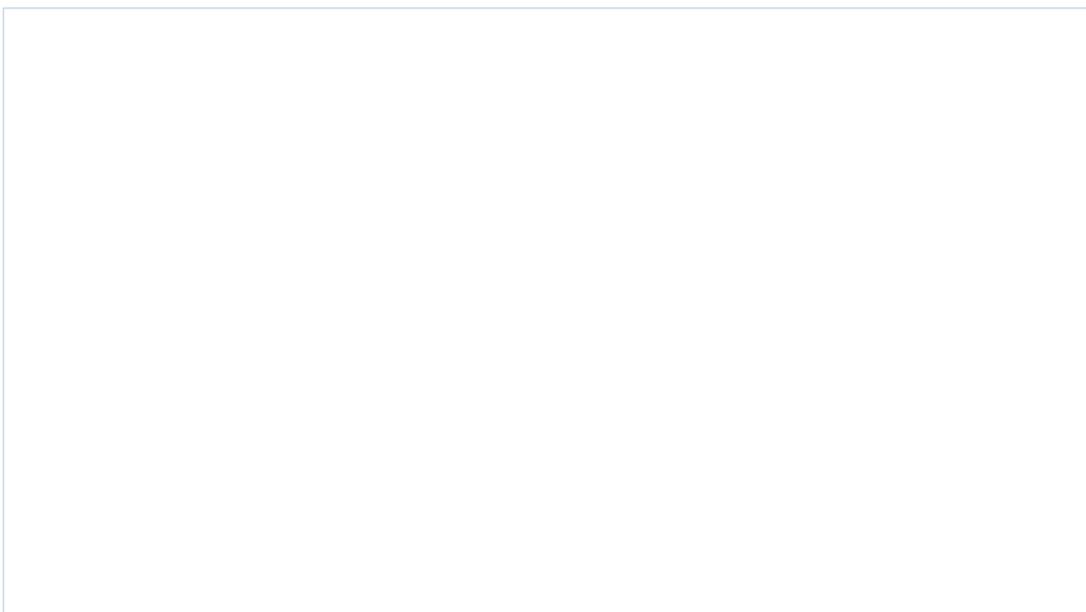
Why is it important to refer to organisational policies and procedures for directives regarding accessing, sharing and storing financial plans and budgets?



### Question 4

---

List four techniques for managing electronic spreadsheets.



# 1B Assess budgets and financial plans with relevant personnel

---

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, the financial plans must reflect this.

Because significant differences exist between the three types of organisations, so too the budgets that are developed differ for each one. However, whatever type of financial plans are developed, they must be clearly written, concise, and accurate; and the documented outcomes should be achievable, with contingencies in place as a risk-control measure.

## Contribute to budgets and financial plans

During budget preparation, regular meetings with relevant personnel allow you to provide feedback from your own perspective and see how the budget will affect your area.

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 are used effectively. Having regular input gives you more ownership of the plans and means you can explain them clearly to your work team.

## Consult with others

By consulting with others during the draft budget preparation and review process, you will ensure that employee knowledge is used, and promote willingness among team members to work within the budget parameters.

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 requirements
- written in plain English
- clear in its intent and all information, and
- accurate in all projections and calculations.

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 to ensure that departmental budgets and objectives align with the overall budget.

Lastly, you may be required to consult with your own work team to ensure that budgetary outcomes and financial plans for the team are achievable. This will include providing time for any questions your team might have or quality feedback they can offer.

Your goal is to ensure the plans are achievable, comprehensible and accurate, as explained below:

<b>Left jigsaw piece</b>	<p><b>Achievable</b></p> <ul style="list-style-type: none"> <li>▪ 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.</li> <li>▪ 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.</li> <li>▪ If the budget has only allowed for one additional part-time staff member to be engaged for a project, you need to know that this is sufficient to enable the team to deliver on time.</li> </ul>
<b>Centre jigsaw piece</b>	<p><b>Comprehensible</b></p> <ul style="list-style-type: none"> <li>▪ You need to ensure that the budget is understandable and logical to ensure all members of the team know what is required and that all aspects are covered.</li> <li>▪ For example, if the budget has allowed for new equipment, check that it also includes money for training staff and ongoing maintenance.</li> <li>▪ Each team member needs to know, which section of the budget, their job role relates to.</li> <li>▪ 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.</li> <li>▪ Any jargon or terminology used should be clearly defined.</li> </ul>
<b>Right jigsaw piece</b>	<p><b>Accurate</b></p> <ul style="list-style-type: none"> <li>▪ You must make sure that the estimates on expenditures and income are a true reflection of the expected costs and revenues.</li> <li>▪ For example, is the quantity and price per tonne of raw materials correct? Can such a quantity be safely stored? Are all projections based on correct calculations?</li> </ul>

## Review draft budgets and financial plans

Review the projected budgetary and financial plan outcomes so you can seek further clarity before the budget period begins.

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. Always be prepared to learn from other colleagues to develop your financial management skills.

Seek out organisational personnel that are responsible for budget preparation and implementation; they will be able to assist you with any queries you may have.

Below are some common financial roles and associated tasks found in organisations:

### 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, providing the opportunity to negotiate for their particular department or section.

### Finance support staff

Finance support 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.

## 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 'sub cost 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) has a face-to-face interview with the budget committee.
- Matters of concern are clarified with the particular cost centre manager as needed.
- For large entities, evidence has to be provided that the various 'sub cost centre' managers or supervisors have provided input into the overall budget preparation for the cost centre.
- When the cost centre budget is approved it is then distributed to all relevant personnel in the cost centre for implementation.

## Budget changes

**Changes to budgets and financial plans may occur for many reasons, some of which may be out of your control.**

Budgets and financial plans often span more than one area, and responsibility for the budgets can sit with more than one person. External decisions can have an impact on an organisation and consequently, its total budget. In many cases, organisations have a contingency fund for adjusting budgets when necessary.

Some reasons for budget changes are listed below:

**Changes to budgets could be necessary for a number of reasons**

- Initial costings have proven inadequate or inaccurate.
- A new staff member is required but was not included in the budget.
- The time allocated to tasks is unrealistic.
- Competition has increased.
- 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 was not budgeted for has to be implemented.

## Practice Task 2

### Question 1

---

Why is it important to review projected budget and financial plan outcomes with required personnel? List three reasons.

## Question 2

---

Which of the following four personnel would you need to consult, when proposing changes to draft budgets and financial plans? Tick all that apply.

- Team members
- Other departmental managers
- Finance personnel
- Suppliers
- Senior manager

# 1C Negotiate changes to budgets and financial plans with relevant personnel

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

On some occasions, you may be required to negotiate with others to change part of the budget to ensure you and your team can achieve designated targets.

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.

Budget negotiations could include:

- allocating additional funds from the organisation's contingency fund
- saving salary through reducing hours
- delaying the purchase of new or replacement equipment
- hiring temporary staff for a short period
- deferring a portion of income targets until periods of higher demand
- dropping a training initiative
- reducing the number of products manufactured.

## Negotiate budget with finance personnel

Any proposed changes to departmental budgets and financial plans will have impacts on other budgets and financial plans within the organisation.

Ultimately, final approval for your budget remains with the financial manager, who is responsible for the overall budget of the organisation. The financial manager is also aware of the organisational expenditure on common goods and services such as stationery, travel and computer equipment.

Negotiating with the financial manager enables you to represent your team or department and understand where the budget may be adjusted.

## Negotiate with managers

You may need to speak with other managers in the event that decisions made and changes in your budget affect their operational responsibilities, 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 its costs.

## Negotiate with team members

As a manager, it is important that you regularly consult your team members on budgetary items and issues 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 costing, 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.

Seek their ideas on 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 while a compromise solution is implemented.

## Deal with conflict

As in any negotiation, skills to resolve conflicts, are important to enable teams to 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.

Where conflict arises between team members, trying using the following strategies:

### 1. Summarise the problem

State the issue, facts, feeling and concerns. Define the problem in terms of conflicting needs, not as a conflict between competing solutions.

### 2. Search for mutually acceptable solutions

Ask both parties to contribute toward a healthy solution. More complex issues may require compromise or collaboration.

### 3. Evaluate the possible solutions

Discuss the possible outcomes of each solution. Will they contribute toward additional problems? Avoid solutions that are unreasonable and unfair toward either participant.

### 4. Decide together

Encourage ownership and a shared commitment of the solution. Ask each participant to summarise their role in implementing the solution and to explain the benefits to both parties. Summarise the actions to be undertaken and reiterate the value of following through on the agreed steps.

## Approve the budget

Recommended variations and adjustments to budget plans that result 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 hoped for. Her manager asks her to cut back on her proposal, which included team members attending a three-day 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 to see whether hiring a consultant to run training sessions would be cheaper than the planned training course.

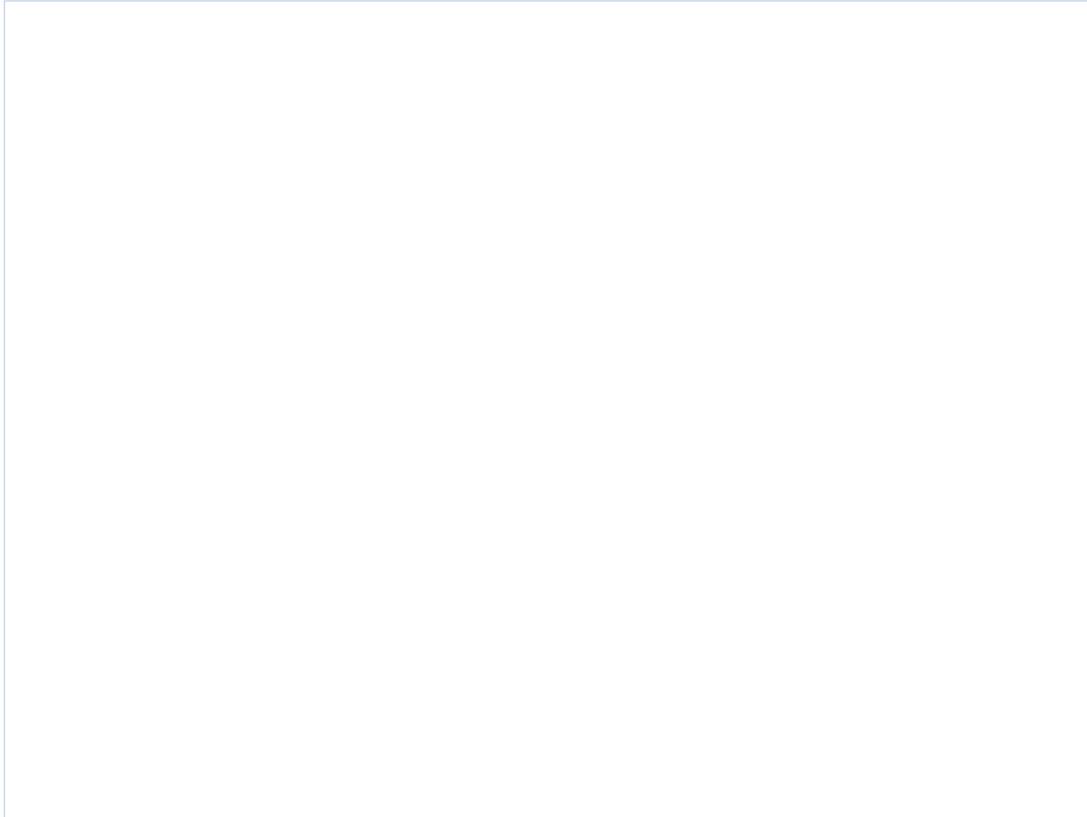
Eventually, Emma is able to present a modified budget that fulfils her team's training needs yet is in line with the organisation's overall financial planning.

## Practice Task 3

### Question 1

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List four key steps you could take to resolve a conflict that arises amongst team members when reviewing and negotiating budgetary changes.



# 1D Prepare for contingencies

Businesses are susceptible to changing markets and circumstances beyond their control, so being flexible and engaging in contingency planning are critical.

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.

## Assess risks

The first step in financial risk management is to identify the risks that an organisation may face and how these would affect the budget.

Organisations should undertake a risk assessment within each department manager and effectively rank each identified risk, from 'most likely to occur' to 'least likely to occur'.

Commencing with the major risk issue, review the current processes in place for managing that risk. This may involve consultation across a broad range of areas within and external to your organisation.

Plans should then be prepared to manage or control the risk by reducing its likelihood or impact if it does occur. This information in turn affects the organisation's budgets and financial plans.

Possible risks and risk control measures are outlined in the following 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 affect cash flow.	Hold greater quantities at an increase in inventory costs.

Risk	Example	Risk control
Price and cost changes	Increased costs of materials and unexpected salary increases add to the labour and production costs, and thus affect cash flow.	Hold greater quantities of inputs or have firmer contractual arrangements in place.
Staff shortages	Sudden illness or departure affects labour costs; you may need to pay other staff overtime to meet production schedules.	Increase casual or flexible labour.
Security breaches	Breaches of confidentiality or privacy of clients reduces their confidence in the company and reduces demands for goods and services.	Put tighter security and confidentiality control measures in place.
Financial loss	Mismanagement of resources, theft or fraud adds to costs and impacts on cash flow.	Increase security measures.
Quality control	Poor standard of products sent to market or incorrect advice given to clients has a negative effect on demand for goods and thus income from sales.	Increase quality control measures and improve staff training.
Environmental impacts	Storms, floods, power failures, water shortages, drought and heat waves have an impact on production.	Spread production across several plants and locations.
Major disasters	An event that causes a serious disruption or termination of operations for a period of time affects 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 products by competitors affects the demand for goods and thus income.	Have a discount sales campaign; targeted market budget; increase design and innovation teams.
Legal and contractual issues	A breach of contract or legal requirement has an impact on the supply of goods and the budget.	Have more detailed contracts and alternative supply options.
Customer behaviour	Satisfaction ratings or changes in spending habits negatively affect sales and cash flow.	Increase advertising and promotion.
Government regulation or behaviour	For example, a ban on advertising a specific product or a tax increase on certain products negatively affect demand, sales and cash flow.	Have options for discount sales or increased promotional advertising.

## Develop contingency plans

Contingency plans are a course of action intended to assist an organisation with responding appropriately to a significant future event, which may or may not happen.

A contingency plan outlines the actions required by managers following a trigger to an identified risk. A trigger creates the circumstance under which a contingency strategy needs to be implemented. This may be due to the failure of a risk control measure, or a major catastrophe that is not covered in existing disaster management plans.

A contingency plan is identified and developed in much the same way as a risk treatment or control measure and is documented accordingly.

Contingency plans and some strategies are outlined below:

### 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.

### 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.

### 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.

### 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.

### Recycling and reusing

- └ Set up systems to obtain greater benefits from inputs by recycling waste, or by reusing various inputs/assets for other purposes.

### Procurement options

- └ Reduce large capital outgoings by not purchasing capital items. Instead, consider:
  - leasing
  - renting
  - hire purchasing assets to spread the payments over time.

### Restructuring

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

### 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.

## Reducing costs

Reduce costs or waste through:

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

## 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 spent 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 was mothballed, in case 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 within four hours and, although slower, was able to maintain production at an acceptable level.

## Practice Task 4

### Question 1

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

### Question 2

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Which of the following contingency plans could be used by an organisation that is continually exceeding their operating expenses budget? Tick all that apply.

- Outsourcing
- Increase budget
- Restructuring
- Sourcing cheaper suppliers
- Succession planning

## Summary

- 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 parts of the organisation's business, such as a sales budget, a labour budget, an inventory budget or an operating expenses budget.
- Managers must know 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.
- Any variations or events that affect the budget need to be identified, documented and negotiated promptly with appropriate personnel within the organisation, such as accountants, frontline managers and supervisors.
- 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.
- 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.
- 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.
- 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 for financial management

#### Part A

1. Where could you access information about your organisation's confidential budgets and financial plans? Tick all that apply.

- Accounting and bookkeeping software
- Excel spreadsheets
- Internet
- Hard copy sources stored with management
- Intranet

2. Identify five personnel within an organisation who could provide you with further clarification on budgeted and financial plan outcomes.

3. What is the relationship between contingencies and triggers? In your answer, explain why it is important for management to diligently track triggering events.

## Part B

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

### Case study

Rosie is the Area Manager for a national clothing retailer in Australia. She oversees the operations of six retail outlets located across the eastern states.

Rosie's responsibilities include monitoring retail sales and expenditure for her region. She must ensure that all six retail outlets are contributing to the organisation's financial objectives by meeting monthly sales targets and effectively managing financial resources.

The finance and budgeting department at Head Office have just prepared the draft budgets for the new financial year and have advised all area managers that they are now available for review. Rosie has scheduled a meeting with her six store managers to discuss the new budget requirements.

Before their meeting, Rosie obtains and reviews the budget and financial plans to familiarise herself with the organisation's new sales and expenditure targets for her area. When reviewing the budget, Rosie notices that sales targets have increased drastically, yet the budgetary allowance for employee wages remains unchanged. She also notices that there have been large cuts to store expenditure across all operations.

She considers ways in which her team can increase monthly sales without recruiting additional staff, and reduce store-operating costs. Rosie prepares herself for a challenging conversation.

During their meeting, Rosie must also lead her team of managers in developing and documenting contingency plans for possible future events, such as increased competitor activity, environmental and major disasters, changes in customer behaviour and stock delays.

1. What consultation strategies could Rosie use when evaluating the new sales targets with her team?

2. Rosie's store managers have each expressed their concern about unrealistic sales and expenditure targets and have pleaded with Rosie to take their feedback to Head Office. What options could Rosie present to Head Office when negotiating more realistic budget outcomes? Tick all that apply.

- Deferring a portion of sales targets until periods of higher demand
- Making additional savings through resource sharing across stores
- Executing the company's contingency plan
- Seeking cheaper suppliers for cleaning, postage and security
- Succession planning

3. Draw a line to match each potential future event to a contingency response plan that would best suit Rosie's team of store managers.

» New competitor opening in an adjacent retail store

» Have alternative locations ready for continuation of the business or as a temporary operational site.

» Major power outage

» Hold greater quantities at an increase in inventory costs.

» Falls in customer satisfaction ratings

» Have a discount sales campaign.

» Delays in receiving stock

» Increase advertising and promotion.



## Topic 2 | Implement and monitor financial management plans

- 2A Communicate budgets and financial plans with team members
- 2B Provide support to team members
- 2C Monitor and control expenditure
- 2D Report on budgets and expenditure

## 2A Communicate budgets and financial plans with team members

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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 affects 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', explain what defines a 'region' and what defines 'metropolitan'.

### Communicate information

When preparing to communicate budget information, consider how you should pass on the information, in what format it will be circulated and when it should be done.

You may choose to hold a budget meeting with your team, where 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 a contact list so that team members can direct inquiries to relevant personnel if they need to query something.

### Communication methods

The method of communication depends on the structure and nature of the organisation, the facilities available, the organisational policies and procedures and the capabilities of the employees.

The organisation's communications policy and procedures should outline strategies for communicating budgets and financial plans. It's important to follow these procedures to make sure ethical and legal protocols are followed.

When selecting the best method of communicating financial information, consider the nature of the workforce. Shift and part-time workers need to be considered so 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.

The language, visuals and terminology you use should be appropriate to the audience and cater for people from non-English speaking backgrounds or with hearing or vision impairment and their varying skills and knowledge.

Many communication methods may be used, as described below:

#### Formal meetings

- Recipients are identified and presented with specific information relevant to their roles and responsibilities.

#### Group meetings/sessions

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

#### Written communication

- Information is sent via written memorandum, letter or report.

#### Face-to-face presentations

- An audience can be selected (this can include such technologies as videoconferencing and teleconferencing).

#### Electronic communication

- Emails are sent to individuals or groups, or documentation is made available on the intranet.

## Communication skills

To ensure understanding and gain support for financial plans and budgets, it is important to communicate the details to all team members in a clear and concise manner.

Your communication should make it easy for all team members to understand their roles and responsibilities in achieving team, departmental and organisational goals and targets.

Using active listening skills and open-ended questions will create opportunities for team members to seek clarification, provide additional input and confirm their acceptance of financial decisions and strategies.

Clear communication can be achieved by:

- using active listening skills to concentrate on and understand what is being said
- using open-ended questioning techniques to confirm team members' understanding
- using verbal and non-verbal communication methods to effectively deliver your message
- keeping communications and recommendations brief
- using written communication to convey large amounts of information
- avoiding acronyms, non-essential information and jargon
- considering the needs of team members whose first language is not English.

## Timing and format

Budget plans and information should be communicated 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 raised during the developmental phase have been addressed. This may require sending out sections of the budget prior to the meeting.

The format for presenting the budget may vary depending on the information being delivered; for example, it 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 communicated 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

#### Communicate budgets to work teams

Ingrid is the CEO of a large clothing company that sells their products to a wide range of retail outlets, domestically and internationally. The Chief Financial Officer (CFO) Graham, is responsible for 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 and any work teams, previously involved in budget preparations, are also briefed by Graham and the relevant cost centre managers.

The following week each cost centre manager distributes 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

### Question 1

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Which of the following methods could you use to communicate budgets and financial plans to team members? Tick all that apply.

- Face-to-face presentations
- Group/team meetings
- Upload them to the organisation's website
- Video conference
- Written communication

### Question 2

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When communicating budgets and financial plans to team members, what communication skills should you use? List at least six.

## 2B Provide support to team members

It is your duty to provide support, advice and guidance for staff members to ensure the budget is implemented successfully.

Once the budget has been communicated to your work team, you need to make sure that everyone understands what they have to do to ensure individuals are equipped to meet team, departmental and organisational financial expectations.

There are three aspects to managing work teams:

1. Ensure roles and responsibilities are understood.
2. Ensure that staff and management have a sufficient knowledge of accounting principles, reports and legislation to be able to carry out their financial management duties competently.
3. Provide support and resources to staff to perform required roles and address any competency gaps.

### Roles and responsibilities

There are 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 the task they have to do, the resources they need, who they report to and who to refer to if they have any difficulties.

The following table shows a range of tasks involved when managing finances and the procedural knowledge required:

<b>Financial operations</b>	<ul style="list-style-type: none"> <li>▪ Ensure security, accuracy and currency of financial operations</li> <li>▪ Understand and apply procedures for:               <ul style="list-style-type: none"> <li>– internal control; for example, secure access to financial data and systems; passwords</li> <li>– authorisations</li> <li>– financial delegation</li> <li>– auditing methods</li> <li>– reporting requirements and reviews.</li> </ul> </li> </ul>
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<b>Invoicing</b>	<ul style="list-style-type: none"> <li>▪ Invoicing clients, customers and consumers</li> <li>▪ Understand and apply procedures connected with: <ul style="list-style-type: none"> <li>– periods for invoicing; for example, weekly, monthly</li> <li>– payment period</li> <li>– discount rates if applicable for certain types of customers</li> <li>– method of distribution; for example, electronic versus post.</li> </ul> </li> </ul>
<b>Record-keeping systems</b>	<ul style="list-style-type: none"> <li>▪ Understand and apply codes for cost centre and accounts.</li> <li>▪ Understand levels of authority for financial record keeping, including approval requirements.</li> <li>▪ Maintain daily financial records by entering transactions into relevant journals; for example, cash payments, cash receipts, purchases and purchase returns and allowances.</li> <li>▪ Maintain the general ledger, including preparing a trial balance.</li> </ul>
<b>Taxation requirements</b>	<p>Understand the requirements for:</p> <ul style="list-style-type: none"> <li>▪ goods and services tax (GST) including calculating, collecting, paying and reconciling payments</li> <li>▪ personal income tax deductions from payroll</li> <li>▪ income tax for businesses</li> <li>▪ fringe benefits tax (FBT)</li> <li>▪ pay as you go (PAYG) tax</li> <li>▪ stamp duty</li> <li>▪ payroll tax.</li> </ul>
<b>Wage/salary payments</b>	<p>Follow procedures for:</p> <ul style="list-style-type: none"> <li>▪ operating the payroll systems</li> <li>▪ calculating gross pay</li> <li>▪ calculating deductions; for example, PAYG Withholding</li> <li>▪ determining net pay</li> <li>▪ transferring funds to nominated accounts</li> <li>▪ paying superannuation contributions</li> <li>▪ record-keeping requirements.</li> </ul>
<b>Petty cash system</b>	<ul style="list-style-type: none"> <li>▪ Understand the petty cash system and required documentation and vouchers, including level of cash float and allowed expenditure.</li> <li>▪ Maintain security and access to petty cash funds.</li> <li>▪ Process reimbursements.</li> <li>▪ Balance and reconcile petty cash fund.</li> </ul>

## The accounting process

Team members need to understand basic accounting principles in order to understand how budgets are met.

An 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

**A chart of accounts is the framework of all of the accounts used in an organisation's accounting system.**

Each account is used to record a particular type of financial transaction and is given a unique account number (code). This coding, which classifies all of the financial transactions within an organisation, affects 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 is used to classify every financial transaction into the appropriate account in the organisation's chart of accounts.

Similar accounts are grouped together by giving them sequential account codes or numbers.

The five account classifications generally used in an organisation's chart of accounts are shown below:

### The five account classifications of the chart of accounts

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

## The concept of accrual accounting

Accrual accounting refers to the recording of revenues and expenses when they have been incurred, regardless of when payment is made.

The organisation's financial performance (profits) can be measured on either a cash or accrual basis.

A short description of the difference between cash and accrual accounting is provided below:

<b>Cash basis</b>	<ul style="list-style-type: none"> <li>Under the cash basis of accounting, an organisation's revenues are recorded in the accounting period when cash is received and expenses are recorded when cash is paid.</li> <li>Cash in this sense refers to the act of payment, not the tender, and can include credit card payments, cheques or bartering as well as cash.</li> </ul>
<b>Accrual basis</b>	<ul style="list-style-type: none"> <li>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).</li> <li>Thus, the concept of receiving or paying cash is not relevant in determining profit.</li> </ul>

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, payment received from a customer may relate to services performed in the previous accounting period. Under the cash basis, this payment would be recorded as revenue when it 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

The matching principle states that all revenues generated in an accounting period should be matched with the expenses incurred in generating them to determine the organisation's performance.

If the revenue exceeds the expenses, the business has made a profit; if the expenses are greater, a loss has been incurred.

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. 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

Adjusting certain balances in the general ledger accounts on balance day will ensure that all revenues and expenses recorded relate to the accounting period in question and not another period in the future.

Balance day refers to the last day of the accounting period; for example, 30 June or 31 December. Whatever date is set for balance day, some transactions are likely to overlap from one accounting period to the next; hence the need for balance-day adjustments.

Once these balance-day adjustments are made, the organisation can then take the next step in the accounting process and begin to accurately prepare its accounting reports and financial statements.

The types of balance-day adjustments that are required are described on the following page:

<b>Accrued expenses</b>	<ul style="list-style-type: none"> <li>▪ Accrued expenses are those that have been incurred in the current accounting period but not paid by the end of the accounting period.</li> <li>▪ 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.</li> </ul>
<b>Prepaid expenses</b>	<ul style="list-style-type: none"> <li>▪ Prepaid expenses are expenses that have been paid in the current accounting period but relate to the next financial year.</li> <li>▪ This results in an overstatement of expenses for the current period as the payment of the expenses will be recorded in the current period.</li> <li>▪ For example, insurance is an expense that is often paid in advance.</li> </ul>
<b>Accrued revenue</b>	<ul style="list-style-type: none"> <li>▪ Accrued revenue is revenue that has been earned in the current accounting period but not received as at the end of the accounting period.</li> <li>▪ 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.</li> </ul>
<b>Prepaid revenue</b>	<ul style="list-style-type: none"> <li>▪ 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.</li> <li>▪ For example, rent earned on a rental property may have been received in advance for the following period.</li> <li>▪ Where revenue has been received in advance, the revenue account must be reduced to ensure the account only includes income for the current period.</li> <li>▪ The amount received in advance is recorded as a liability; that is, it is owed to the person or organisation that paid in advance.</li> </ul>
<b>Depreciation</b>	<ul style="list-style-type: none"> <li>▪ Depreciation is the allocation of the capital cost of an asset over its estimated useful life.</li> <li>▪ The two most commonly used ways of calculating depreciation are the straight-line and reducing-balance methods.</li> <li>▪ As depreciation is normally recorded at balance day, it is regarded as a balance-day adjustment. It is a part of the process that ensures that all expenses incurred for the current accounting period are recorded, and that the assets are reported at their written-down value.</li> </ul>

<b>Bad debts</b>	<ul style="list-style-type: none"> <li>▪ 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.</li> <li>▪ 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.</li> <li>▪ It is standard practice to estimate the value of debts unlikely to be collected in the future from credit sales made in the current accounting period.</li> <li>▪ 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.</li> <li>▪ An age analysis classifies debtors according to how long their accounts have been outstanding.</li> <li>▪ The classifications are usually broken down into 0 to 30 days, 31 to 60 days, 61 to 90 days and 91 days or longer.</li> </ul>
<b>Trading stock</b>	<ul style="list-style-type: none"> <li>▪ Trading stock, sometimes referred to as inventory, consists of the goods an organisation buys from suppliers and sells to its customers.</li> <li>▪ 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.</li> <li>▪ Purchases of trading goods are recorded in the purchases expense account.</li> <li>▪ In accordance with the accrual accounting concept, purchases are recognised in the period in which they are incurred.</li> <li>▪ 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 purchase expense for this accounting period.</li> <li>▪ 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.</li> </ul>
<b>Provision for leave</b>	<ul style="list-style-type: none"> <li>▪ 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.</li> <li>▪ 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.</li> <li>▪ 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.</li> </ul>

## Recording balance-day adjustments

Adjusting entries must be recorded before publishing the final version of the financial statements.

The tasks that must be performed to record adjustment entries at balance day are illustrated below:

Sequence of balance-day activities
End of accounting period – balance day (usually 30 June)
Record balance-day adjustments in general journal (adjustments include amounts owing and amounts prepaid)
Post adjustments from the general journal to the general ledger
Prepare financial statements

## Assets

**An asset is a resource of value, owned or controlled by an organisation, that can be converted into cash.**

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 future 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.

### 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: current and non-current assets.

Non-current assets can be classified further into the following three categories:

- Tangible assets (also known as 'property, plant and equipment' or 'fixed assets') are physical assets. Examples of tangible 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.

Examples of current and non-current assets are provided below:

#### Current assets

Current assets are assets whose future economic benefits will be consumed by the organisation within the current accounting period (usually 12 months). For example:

- cash
- debtors
- inventory.

#### Non-current/Fixed assets

Non-current/fixed assets are assets whose future economic benefits will extend beyond the current accounting period. For example:

- premises and buildings
- motor vehicles
- equipment
- machinery
- office equipment.

## Asset register

**An asset register is a database or document that contains specific information about the assets that an organisation owns or controls.**

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

## 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.

## Depreciation

Depreciation refers to an asset's reduction in value over time due to wear and tear.

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:

<b>Straight-line depreciation</b>	<ul style="list-style-type: none"> <li>• Also known as prime-cost depreciation or on-cost depreciation.</li> <li>• 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.</li> </ul>
<b>Reducing-balance depreciation</b>	<ul style="list-style-type: none"> <li>• 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.</li> <li>• 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.</li> <li>• The outcome of using the reducing-balance depreciation method is that annual depreciation is higher in the early years of the asset's estimated useful life than in the later years.</li> </ul>

## 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 set up and used for the purpose of determining profits or 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 process used by businesses to close their accounts is described below:

<b>A business that buys stock, marks up and on-sells (trading)</b>	<ul style="list-style-type: none"> <li>▪ Enters general journal entries for closing revenue, expense and stock account balances</li> <li>▪ Posts revenue, expense and stock account balances to the trading account and profit and loss accounts</li> <li>▪ Determines gross and net profits</li> <li>▪ Closes accounts to the capital account</li> </ul>
<b>A business providing a service</b>	<ul style="list-style-type: none"> <li>▪ Enters general journal entries for closing revenue, expense and supplies account balances</li> <li>▪ Posts revenue, expense and supplies account balances to the cost of supplies account and profit and loss accounts</li> <li>▪ Determines cost of supplies and net profits</li> <li>▪ Closes accounts to the capital account</li> </ul>

## The trading account

The trading account is used by organisations that buy and sell goods; that is, trading organisations.

The purpose of the trading account is to determine an 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.

## 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 gross profit or loss can be determined.

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 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:

<b>Gross profit</b>	<b>+</b>	<b>Non-trading revenue</b>	<b>-</b>	<b>Other operating expenses</b>	<b>=</b>	<b>Net profit /loss</b>
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If an organisation has recorded a gross loss, the equation would be:

<b>Gross loss</b>	<b>+</b>	<b>Other operating expenses</b>	<b>-</b>	<b>Non-trading revenue</b>	<b>=</b>	<b>Net profit /loss</b>
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## 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 are the profit and loss statement and the balance sheet.

The profit and loss statement (also known as the statement of financial performance) reports on the revenue and expenses for the year.

The profit and loss statement 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 2020'.

#### 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.

## Balance sheet

The balance sheet (also known as the statement of financial position) is a listing of the organisation's assets, liabilities and owner's equity balances.

The balance sheet 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 2019. 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 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.

### 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 are 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.

## Cash flow reports

Cash flow refers to the incomings and outgoings of cash for an organisation.

Cash is different from profit: an organisation may be profitable, but have a negative cash flow, and therefore not be able to pay its debts. Many organisations have numerous assets, but minimal accessible cash.

It is important to regularly monitor an organisation's cash flow. If a negative cash flow position is likely, additional cash may need to be borrowed or an overdraft facility put into place.

A cash flow projection is required to obtain finance and future cash flows are determined by the expected timing of income and expenditure.

### Review cash flow statements

Cash flow statements comprise three elements: operating activities, investing activities and financing activities. The most important of these elements is the operating activities element.

#### Operating activities

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

#### Investing activities

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

#### Financing activities

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

## Ageing summaries

Ageing summaries are useful accounting reports that show how long an organisation has had an asset, or how long a bill has gone unpaid.

There are two main ageing summaries:

- the accounts receivable ageing summary (also called the aged debtors report/summary)
- the accounts payable ageing summary (also called the aged creditors report/summary).

### Accounts receivable ageing summary

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

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

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

## Example

### Accounts receivable ageing summary

Aged debtors summary as at 30th June 20XX					
Debtor	Total AR	1 - 30 days	31 - 60 days	61 - 90 days	over 90 days
	\$	\$	\$	\$	\$
P. Steinway	-				
D. Sparks	654.50			654.50	
M. Brown	-				
P. Daley	1 105.50				1 105.50
M. Lark	855.00	605.00	250.00		
L. Rogers	1 078.00	1 078.00			
	<b>\$ 3 693.00</b>	<b>\$ 1 683.00</b>	<b>\$ 250.00</b>	<b>\$ 654.50</b>	<b>\$ 1 105.50</b>

The above summary helps management to:

- identify which invoices are overdue for payment and by how much
- estimate the amount of potential bad debt so that adjustments can be made in the general ledger
- determine the effectiveness of the credit and collections functions.

### Accounts payable ageing summary

The accounts payable ageing summary is a listing, or report, that outlines the due dates of the bills and invoices an organisation needs to pay.

The summary helps management to quickly recognise the payments due in the current month, the following month and so forth. Payments due to creditors and suppliers can then be factored into the organisation's cash flow requirements.

## Statutory reporting 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 reports must be submitted; the formats to be used when supplying the information and the timelines for their completion and submission.

An important part of your role is to ensure all information in both source and submitted documents is accurate, relevant and reliable.

## The main regulatory bodies

Regulatory bodies are organisations set up to develop, administer, monitor and enforce regulatory functions.

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

### 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 2001* (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.
- Accounts for public companies 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 cash flow.
- 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.

#### 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).

#### Australian Securities 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 cash flow statements during the periods in which the expenditure is being undertaken. Mining companies must also lodge quarterly cash flow reports and summaries of mining exploration activities during the period.

#### 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, cash flow 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.

## Submitting statutory reports

Throughout the year, there are important deadlines that have to be met 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 lodgement of funds, such as payment schedules, as well as information.

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.

You should know the submission dates of all financial reports, whether they are statutory guidelines or internal deadlines your 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.

## Changes to statutory reporting requirements

You need to continually update your knowledge to keep abreast of any changing reporting 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 below:

#### 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

## Australian accounting standards

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

Australian accounting standards are maintained by the Australian Accounting Standards Board (AASB), an Australian Government agency whose functions are set out in the *Australian Securities and Investments Commission Act 2001* (Cth).

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 15 – Revenue from contracts with customers

AASB 15 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.

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: [aspirelr.link/aasb](http://aspirelr.link/aasb)

## Audit

The process of auditing accounts ensures that source data is accurately recorded for each and every financial transaction.

Auditing also shows that an organisation's accounts have been prepared in accordance with statutory requirements.

The difference between primary and secondary source data is explained in the following table:

<b>Primary source data</b>	<p>The primary source data for an organisation's financial transactions may be either hard copy or electronic and generally includes:</p> <ul style="list-style-type: none"> <li>▪ purchase requisitions</li> <li>▪ purchase orders</li> <li>▪ delivery dockets</li> <li>▪ cash register rolls</li> <li>▪ receipts</li> <li>▪ credit card vouchers</li> <li>▪ credit card merchant summary</li> <li>▪ cheques received listing</li> <li>▪ bank deposit forms</li> <li>▪ statements of account</li> <li>▪ cheque requisitions</li> <li>▪ cheques/cheque butts</li> <li>▪ remittance advices</li> <li>▪ invoices (GST-free)</li> <li>▪ tax invoices</li> <li>▪ adjustment notes issued and received</li> <li>▪ petty cash vouchers.</li> </ul>
<b>Secondary source data</b>	<p>Secondary records of income and expenditure include:</p> <ul style="list-style-type: none"> <li>▪ journals and ledgers in which purchases and income items are recorded</li> <li>▪ stock-on-hand records that measure movements of stock in and out as a result of sales and restocking</li> <li>▪ bank statements.</li> </ul>

## Comply with tax legislation

In order for an organisation to meet its statutory reporting requirements, the calculation and submission of taxation liability is an important task.

It is important to be aware of the type of revenue that may not be part of your organisation's everyday operations, but is taxable and 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	<p><b>Proceeds from the sale of goods</b></p> <p>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.</p>
2	<p><b>Fees from the provision of services</b></p> <p>Income from services is generally fee-based, such as professional legal services, or plumbing services. It is considered income in the same way as revenue from physical goods and should be recorded in the accounts as such.</p>
3	<p><b>Rental or lease income from the use of assets by others</b></p> <p>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.</p>
4	<p><b>Disposal of working assets for a profit</b></p> <p>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.</p>
5	<p>Income from the use of cash assets</p> <p>For example, income from loans.</p>
6	<p><b>Interest</b></p> <p>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.</p>
7	<p><b>Revenue received from royalties</b></p> <p>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 license.</p>
8	<p><b>Dividend income received as a return from the ownership of shares in another business</b></p> <p>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.</p>

## 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.

<b>Goods and Services Tax (GST)</b>	<ul style="list-style-type: none"> <li>▪ Most organisations with an annual turnover of \$75 000 or more are required to register for GST. Not-for-profit organisations must register for GST if their annual turnover exceeds \$150 000. Annual turnover is the total revenue from sales and services provided for the year, excluding GST.</li> <li>▪ Organisations with an annual turnover below the threshold are also able to register for GST, although it is not compulsory.</li> <li>▪ 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:             <ul style="list-style-type: none"> <li>– accounting for GST on all taxable sales and supplies (one-eleventh of the total sale price)</li> <li>– issuing tax invoices</li> <li>– accounting for and claiming GST paid (Input Tax Credits) on all taxable purchases (one-eleventh of the total purchase price)</li> <li>– 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.</li> </ul> </li> <li>▪ For more information on GST, including reporting deadlines for business activity statements, visit: <a href="https://aspirelr.link/ato-gst">aspirelr.link/ato-gst</a></li> </ul>
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<p><b>Pay As You Go (PAYG)</b></p>	<ul style="list-style-type: none"> <li>▪ PAYG is a system of taxation on income. PAYG legislation is found in Schedule 1 of the <b>Taxation Administration Act 1953 (Cth)</b> and is broken down into two areas.</li> <li>▪ 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.</li> <li>▪ 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.</li> <li>▪ The list of withholding payments is quite extensive and includes: <ul style="list-style-type: none"> <li>– wages and salary payments to employees</li> <li>– commissions, bonuses and allowances</li> <li>– directors' fees</li> <li>– eligible termination payments</li> <li>– unused leave paid on termination</li> <li>– social security payments</li> <li>– compensation, sickness and accident payments</li> <li>– withholding of 47 per cent on payment of supplies where a supplier does not quote a valid ABN.</li> </ul> </li> <li>▪ Payers of withholding payments must register for PAYG withholding. To register for PAYG withholding, organisations must hold a valid ABN.</li> <li>▪ For more information on PAYG withholding, visit: <a href="https://aspiirelr.link/ato-payg">aspiirelr.link/ato-payg</a></li> </ul>
<p><b>PAYG instalments</b></p>	<ul style="list-style-type: none"> <li>▪ 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.</li> <li>▪ 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.</li> <li>▪ 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.</li> <li>▪ For more information on PAYG instalments, visit: <a href="https://aspiirelr.link/ato-payg-instalments">aspiirelr.link/ato-payg-instalments</a></li> </ul>

<b>Fringe Benefits Tax (FBT)</b>	<ul style="list-style-type: none"> <li>▪ Organisations that provide employees with payments in the form of non-cash benefits may be required to register for and remit FBT to the Australian Taxation Office.</li> <li>▪ The FBT rate for the years ending 31 March 2017 to 31 March 2021 is 47%. 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 FBT include: <ul style="list-style-type: none"> <li>– cars: arises when a car owned or leased by an employer is made available for the private use of the employee</li> <li>– loans: 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</li> <li>– housing: 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</li> <li>– airline transport: arises when an employer provides airline transport (for-non-work-related travel) to an employee for free or at a discounted rate.</li> </ul> </li> <li>▪ 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.</li> <li>▪ 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.</li> <li>▪ For more information on FBT, visit: <a href="https://aspiirelr.link/ato-fbt">aspiirelr.link/ato-fbt</a></li> </ul>
<b>Superannuation guarantee levy</b>	<ul style="list-style-type: none"> <li>▪ 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.</li> <li>▪ 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.</li> <li>▪ 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.</li> <li>▪ There are some categories of employees that are not eligible to have superannuation paid on their behalf. These include employees who are: <ul style="list-style-type: none"> <li>– paid less than \$450 gross per month</li> <li>– aged under 18 years and working less than 30 hours per week</li> <li>– performing work of a domestic or private nature and working less than 30 hours per week.</li> </ul> </li> <li>▪ 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.</li> <li>▪ For more information on the Super guarantee, visit: <a href="https://aspiirelr.link/ato-super">aspiirelr.link/ato-super</a></li> </ul>

<b>Payroll tax</b>	<ul style="list-style-type: none"> <li>▪ 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.</li> <li>▪ 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: <ul style="list-style-type: none"> <li>– wages and salaries</li> <li>– leave payments</li> <li>– allowances</li> <li>– bonuses and commissions</li> <li>– superannuation guarantee levy</li> <li>– fringe benefits</li> <li>– directors' fees.</li> </ul> </li> <li>▪ These are recorded in the payroll accounts. Some types of payments are generally not subject to the payroll tax calculation and include: <ul style="list-style-type: none"> <li>– payments to or on behalf of apprentices or registered trainees</li> <li>– workers' compensation payments</li> <li>– redundancy payments.</li> </ul> </li> <li>▪ Each state and territory has its own specific exemptions. Be familiar with those that are applicable to your state or territory.</li> <li>▪ 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.</li> <li>▪ For more information on payroll tax, visit: <a href="https://aspirelr.link/payroll-tax">aspirelr.link/payroll-tax</a></li> </ul>
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## Late lodgements

Remember that late lodgements to some regulators, particularly with regard to taxation lodgements, 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.

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 lodgement dates for the following statutory reporting requirements:

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

You can access this information at: [aspiirelr.link/ato-gov](https://aspiirelr.link/ato-gov). Select the relevant topic from the navigation bars.

## Organisational policies and procedures

**All financial procedures should be clearly documented in an organisation's policies and procedures manual, and easily accessible to all staff.**

In order to manage the teams work load and ensure documents are stored correctly, you might 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 communicating information are summarised in the following table:

Intranet-based information
<ul style="list-style-type: none"> <li>• 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.</li> <li>• 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.</li> </ul>

#### 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 desks 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 employees

**A successful organisation is committed to professional development and ongoing training for employees.**

Part of your role as a manager of a team requires you to support the team including new employees. New employees will have taken part in an initial induction program, however, all staff require training at some point. This may be due to circumstances changing, 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 in house 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 company. 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 after working for more than seven years in the position Michelle now holds. Michelle has indicated she wishes to work towards achieving her professional year as an accountant and becoming a Certified Practising Accountant (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.

## Access required resources

Organisations must ensure staff have access to the required resources and systems, so they can perform their functions effectively and efficiently.

The types of 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.

## Human resources

Human resources include consideration of an employee's time as well as their knowledge, training and experience.

Your work team will require sufficient resourcing to handle the varied financial tasks and responsibilities such as purchasing, debt collection or handling petty cash. This may be in addition to other team-specific tasks including sales, marketing, and administration.

Staff numbers required should have been identified when planning the team's budget. You may find that you need to contract or outsource staff, look more closely at the make-up of the team and monitor the effectiveness of full-time, part-time and casual workers or hire more staff.

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

## Physical resources

Physical resources are an important consideration enabling your staff to work effectively.

To manage finances effectively, a manager needs to ensure 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, ergonomically designed 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 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

- Cash flow management – expected timing of income and expenditure and demands
- 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

## Technological resources

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 should provide 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 software systems are listed in the following table:

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

**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.**

All financial operations must be accurate, transparent, tracked, carefully documented and easily accessible. Many large and medium organisations must comply with the Australian and International Standard, AS ISO 15489 Australian records management standard.

There are a range of systems within 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.

Some of these are listed below:

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.

## Legislative requirements for record-keeping

**In order to prepare accurate tax returns and support any claims, it is important to retain records.**

The Australian tax system relies on self-assessment, which means that organisations are responsible for working out how much to declare and claim on tax returns. They are also required to be able to show how they arrived at these figures.

Generally, organisations must retain written evidence for five years from the date they lodge a tax return.

Keeping accurate records will help with the following:

- providing evidence of income and expenses
- preparing tax returns
- claiming entitlements
- reducing the risk of tax audits and adjustments
- improving communication with the ATO
- resolving issues relating to disputed assessments or adjustments
- avoiding penalties.

## Example

### Conducting 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 to 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.

## Practice Task 6

### Question 1

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

- A business that is registered for GST should include the GST when recording the capital cost of an asset in the asset register.
- The profit and loss statement (also known as the statement of financial performance) reports on the revenues and expenses for the year, and excludes GST.
- A cash flow budget should include the GST on cash inflows and outflows, where applicable.
- The records management system is an imprest system and includes all the controls, policies, procedures and forms used by an organisation to dispense small amounts of cash for miscellaneous needs.

## Question 2

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List eight examples of financial records that must be kept for auditing and record-keeping purposes.

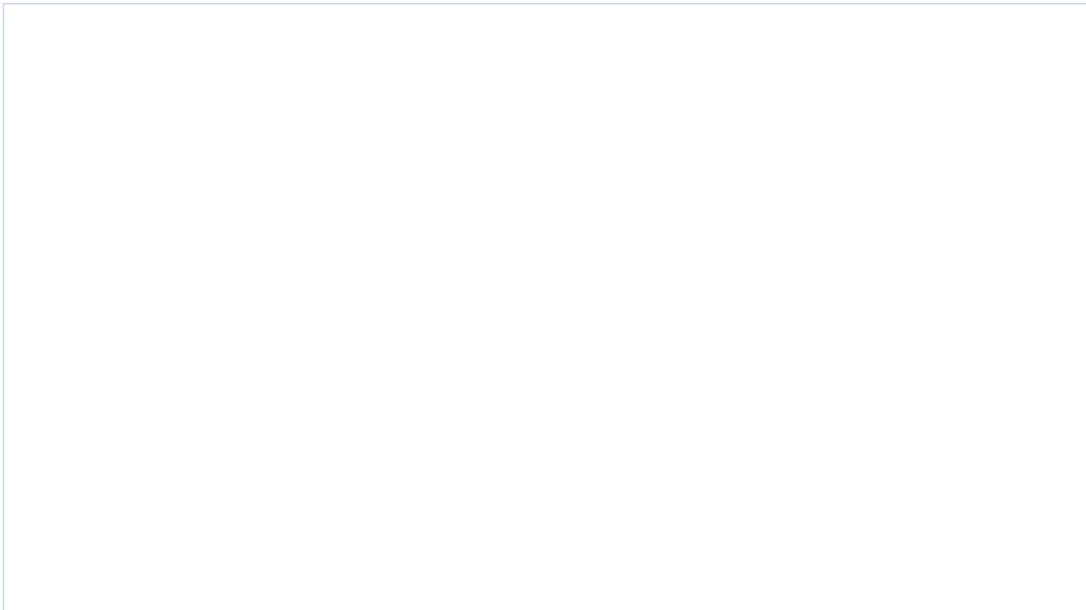


## Question 3

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Briefly summarise how each of the following techniques is used to support and monitor team members in their roles.

- Mentoring
- Coaching
- Shadowing



## Question 4

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

- Most organisations with an annual turnover of \$25 000 or more are required to register for the goods and services tax (GST).
- Payroll tax is a state/territory tax imposed on organisations with a total Australian payroll that exceeds the annual payroll tax threshold of \$600 000.
- All employers are required to contribute to a complying superannuation fund for all eligible employees (currently a minimum of 9.5 per cent of gross ordinary income).
- Throughout the financial year, organisations must lodge activity statements and forward payments to the ATO in accordance with the Pay as you go (PAYG) system.
- Fringe benefits tax (FBT) is paid by employers on certain benefits they provide to their employees or their employees' family or other associates.

## Question 5

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Draw a line to match each organisational resource to its correct resource type.

- |                                   |                  |
|-----------------------------------|------------------|
| » Plant equipment and machinery   | » Financial      |
| » Investor funds                  | » Human          |
| » Policies, processes and systems | » Physical       |
| » Cloud-based accounting software | » Organisational |
| » Employee knowledge              | » Technological  |

## 2C Monitor and control expenditure

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.

A key part of monitoring expenditure is to record information, identify cost variations and expenditure overruns and report results to the relevant personnel 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.

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.

A 'Starting a business' toolkit has been published online for business start-ups by Business Victoria. It is free to join and provides access to a range of instructional material, templates and examples at: [aspirelr.link/business-toolkit](https://aspirelr.link/business-toolkit)

### Understand cost elements

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.

To produce a product or service requires materials and labour that must be purchased. Organisations also incur other costs not directly attributable to the materials or labour of the goods or services and these are called overheads.

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

These four cost elements are listed and described below:

#### Direct materials costs

- Direct materials costs are the cost of the materials 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 produced.
- 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 ongoing costs that cannot be directly linked to the production of a good or delivery of a service. These can be 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, by determining:
  - the overhead cost per hour for billable labour hours and adding this to the actual labour rate
  - the overhead cost per job for the anticipated number of jobs to be done and allocating an initial job fee or service fee
  - 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 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.

## Performance indicators

**Performance indicators are a measurable value that demonstrates how effectively an organisation is achieving key business objectives.**

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 centres or budget managers to take appropriate action to correct issues identified by a variation between budget position and the actual position at a point in time.

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

## Financial performance indicators

Financial indicators measure the bottom line of any business. Financial indicators include profit, changes in balance sheets, market share fluctuations and returns on capital investment.

Some examples of these financial indicators are shown here:

<b>Profit indicators</b>	Profit or return indicators; for example: <ul style="list-style-type: none"> <li>gross profit against sales (measured as a percentage)</li> <li>net profit against sales (measured as a percentage)</li> <li>gross profit against labour cost component of goods sold (measured as a percentage)</li> <li>net profit against labour cost component of goods sold (measured as a percentage).</li> </ul>
<b>Balance sheet changes</b>	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.
<b>Market share</b>	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.
<b>Return on capital</b>	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 3 per cent.

## Non-financial performance indicators

**Non-financial performance indicators are quantitative measures that cannot be expressed in monetary units.**

Non-financial performance indicators or key performance indicators (KPIs) focus on various activities related to an organisation or a department. Such indicators will vary substantially, depending on the nature of the business.

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 an area will ultimately affect the bottom line of the organisation.

Some common indicators are shown below:

Non-financial performance indicators	
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

Accurate monitoring of expenditure requires that each item of expenditure is recorded appropriately against the relevant cost codes.

Cost codes are found in the chart of accounts and used when developing budgets. Similarly, income 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 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	<ul style="list-style-type: none"> <li>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.</li> <li>An annual stocktake of assets and their condition is essential.</li> </ul>
Consumables	<ul style="list-style-type: none"> <li>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.</li> </ul>

<b>Equipment</b>	<ul style="list-style-type: none"> <li>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.</li> <li>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.</li> </ul>
<b>Expenditure</b>	<ul style="list-style-type: none"> <li>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.</li> </ul>
<b>Income</b>	<ul style="list-style-type: none"> <li>Income is monies received from the sale of products and services, income through investments, and donations. Accurate ledgers and financial statements must be maintained.</li> </ul>
<b>Stock</b>	<ul style="list-style-type: none"> <li>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.</li> </ul>
<b>Wastage</b>	<ul style="list-style-type: none"> <li>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.</li> </ul>

## Monitor expenditure

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.

Variance 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'.

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

### Aggregated report

Report on performance for December 2014

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 5 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 variance limits

Acceptable variances will vary between organisations, so you will need to be familiar with your organisation's acceptable variance limits.

In this way, you won't spend too much time looking at a \$5 variation in an item listed at \$1500.

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 \$2400 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 \$2400; 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.

## Reasons for variances

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.

Some examples of variances, whether they are favourable or not and possible causes are presented below:

<b>Low sales income (unfavourable)</b>	Does it suggest a trend and the potential that you won't shift products at current prices? Or is there a seasonal impact to consider (for example, overcoats won't sell much in summer)?
<b>Excessive expenditure (unfavourable)</b>	Is there a seasonal issue? Has the organisation bought resources in bulk and thus has them in stock, or has the input price risen?
<b>Low expenditure (favourable)</b>	Are there seasonal or irregular patterns of expenditure involved? Has there been a reduction in the price of the inputs, or is less of the input required due to some other factor?
<b>Excessive sales income (favourable)</b>	Does it suggest that demand is up and that you may need to increase production, since stocks of finished products for sale are getting low?

## Frequency of monitoring

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

### 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:

Item	Budget (\$)	Actual (\$)	Variance result
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.

Item	Budget (\$)	Actual (\$)	Variance result
Sales	40 000	50 000	10 000 F

## Investigate cost overruns

Once costs outside the budget have been identified, it's important to investigate further to find out why, then appropriate action can be 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 are shown below:

Steps to investigate cost overruns
1. Seek confirmation of the variation by analysing source documentation relating to the areas of expenditure.
2. If the variation is confirmed, determine if there are any seasonal factors or ordering timelines that may have contributed to this variation or that the budget expenditure has been evenly spread across the twelve months.
3. Document the reasons and advise your supervisor and continue to monitor the situation.

If, after seeking input from team members, a cost overrun cannot be justified, detail the situation and report this to your supervisor.

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 some options for controlling the costs and minimising the impact.

## Implement control processes

There are many reasons why expenses can exceed your budget. The key is to understand why it's happening and what needs to be done about it.

Many of the approaches to controlling costs should have been considered well before the cost overruns are detected, in the form of contingency planning.

Control processes that can be implemented are 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.

### 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

- Ban 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; employ fewer casual staff; 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 step 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:

- considering the needs of the whole new entity before ordering materials such as stationery
- purchasing equipment such as new printers and photocopiers that are capable of servicing a larger group of staff, so the demand for such equipment is reduced
- adjusting position descriptions where there is some duplication in responsibilities so that, when an employee leaves the organisation, their responsibilities can be combined into existing roles before seeking a replacement.

## Contingency plans

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; once implemented, these plans have to be monitored and appropriate reports produced. Contingency plans need to be reviewed during the financial planning period and on an ongoing basis, to ensure they are still current and will work if needed.

### 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. Effectively, the aim is to reverse any significant, unfavourable variances in the budget variance analysis reports into favourable variances in the future reporting periods.

Contingency plans should, therefore, clearly support the objectives of an 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. Appropriate analysis techniques in addition to variance analysis on budgets may need to be considered.

The diagram on the following page details 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.

## Modify contingency plans

Contingency plans should be reviewed as part of the ongoing management of a cost centre and the associated budgets to ensure they are functional.

Contingency plans should be modified as, and when, issues are identified that indicate they would fail to correct a problem. They should not be left in a drawer or on a shelf pending their potential implementation.

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.

### 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 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 will need to be reviewed and updated as the situation with the competitor is monitored.

## Practice Task 7

### Case study

Analyse the incomplete profit and loss variance report below, then answer the question that follow. (You will need to perform your own mathematical calculations to answer the question.)

Profit and loss variance report for the month of July 2019					
Item	Budget (\$)	Actual (\$)	Variance (\$)	Variance (%)	Fav/Unfav
Income					
Area A	45 000	44 832			
Area B	70 000	59 130			
Area C	55 000	60 552			
Gross profit	170 000	164 514			
Expenditure					
Salaries	51 000	56 950			
Marketing and sales	21 715	21 725			
Administration	12 465	16 550			
Consumables	18 269	18 354			
Repairs and maintenance	3 550	10 456			
Depreciation expense	12 000	12 000			
Total operating expenses	128 999	136 035			
Net profit	41 001	28 479			

## Question 1

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Which of the following statements correctly reflects July's financial results? Tick all that apply.

- Net profit for the month of July came in 40 per cent under budget.
- Net profit for the month of July came in 37 per cent under budget.
- Contingency response plans must be enacted immediately to bring marketing and sales expenditure back in line with budget.
- The dollar variance for salaries for the month of July is \$5950 favourable.
- Controls should be put in place to effectively manage administrative expenditure.

## Question 2

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Provide five examples of cost control processes that can be implemented to reduce over-spending.

### Question 3

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Why is it necessary to review and occasionally modify contingency plans? In your answer, provide a practical example.



## 2D Report on budgets and expenditure

Reporting on budgets and expenditure is the role of a cost centre manager and others with budgetary responsibilities.

Budget and expenditure reports act as a formal record of achievements and issues that have arisen, and document the reasons for decisions made. Reports not only provide a commentary on the past and present situation but, importantly, guide organisations in making appropriate decisions to achieve future business objectives.

External authorities, such as regulatory bodies and other stakeholders, also require true and accurate reports on business activities and outcomes.

### Organisational policies and procedures

You will need to follow your organisation's policies and procedures for preparing, lodging and/or authorising financial reports.

Be familiar with the organisation's financial reporting calendar and know when reports are due 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 cash flow.

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

Various reports are required, including financial and business operating reports for organisational personnel, statutory reporting bodies and key decision makers.

Every organisation, from small business to large enterprise, needs to assess its achievements against budget and report on a regular basis.

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

Regular reports
<ul style="list-style-type: none"> <li>▪ Regular reports (also called standard or periodic reports) are produced to report on activities such as budget management and expenditure, including profit-and-loss statements, cash flow statements and balance sheets, or to report to appropriate authorities such as the ATO.</li> <li>▪ 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.</li> </ul>
Progress or project reports
<ul style="list-style-type: none"> <li>▪ These reports are prepared to describe achievements up to a specific period.</li> <li>▪ The focus is on achievements against a plan, issues being faced, actions taken and recommendations on maintaining project deliverables.</li> </ul>
Requested or issue-generated reports
<ul style="list-style-type: none"> <li>▪ These may be requested from higher authorities or initiated in response to a particular situation or issue.</li> <li>▪ For example, a report on options to address events such as a shortage and significant increase in the price of raw materials.</li> </ul>

## Financial reports

Compiling timely and accurate financial reports is vital to effective financial management and enables organisations to better manage profitability, achieve budgetary outcomes and meet statutory requirements.

Information or data for compiling financial reports on budgets and expenditure can come from a range of sources, as outlined below:

<b>Bank statements</b>	<ul style="list-style-type: none"> <li>Bank statements provide evidence of transactions (deposits and withdrawals) and can be reconciled against financial system records.</li> <li>They also identify bank charges and any interest that might be paid.</li> </ul>
<b>Credit card statements</b>	<ul style="list-style-type: none"> <li>Credit card statements provide a record of expenditure, along with substantiation documentation if required.</li> <li>They are also used for payments of the credit card accounts.</li> </ul>
<b>Financial reports</b>	<ul style="list-style-type: none"> <li>Profit-and-loss reports and balance sheet reports detail the financial performance of the organisation and its current financial position.</li> </ul>
<b>Invoices and receipts</b>	<ul style="list-style-type: none"> <li>Invoices and receipts provide details of monies owed and monies received.</li> </ul>
<b>Ledgers and journals</b>	<ul style="list-style-type: none"> <li>Ledgers are the database for an organisation's accounting records.</li> <li>Journals are the details of the transactions and include authorisations for adjustments made to the ledger.</li> <li>Financial statements are generated from ledgers using the chart of accounts.</li> </ul>
<b>Logs</b>	<ul style="list-style-type: none"> <li>Logs provide details and records on: <ul style="list-style-type: none"> <li>hours worked for wages; for example, time sheets</li> <li>motor vehicle usage; for example, car log books</li> <li>equipment operations; for example, hours of operation of major equipment</li> <li>maintenance log books and service records for equipment.</li> </ul> </li> </ul>
<b>Petty cash records</b>	<ul style="list-style-type: none"> <li>Petty cash records provide details on the nature and amounts of expenditure via the petty cash system.</li> </ul>
<b>Spreadsheet records</b>	<ul style="list-style-type: none"> <li>Spreadsheet-based records are generally associated with the operation of a small to very small business.</li> <li>Many use software such as MYOB (Mind Your Own Business) or QuickBooks in order to generate relevant reports they wish to use and require at the end of the financial year for tax time.</li> </ul>

## Techniques for preparing written reports

A written report should be prepared and planned with a clear objective in mind and knowledge of the reader.

Some techniques for writing reports are shown below:

<b>Characteristics of good reports</b>	<ul style="list-style-type: none"> <li>▪ 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.</li> <li>▪ 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.</li> <li>▪ Genuine – data is from a trustworthy and honest source.</li> <li>▪ 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.</li> <li>▪ Positive and proactive – it is concerned with the future and leads in that direction.</li> <li>▪ Well-timed – it is appropriate to the time when decisions need to be made.</li> <li>▪ Well-presented – uses current technology and software to compile, integrates and presents clear information to the end user.</li> </ul>
<b>Things to avoid</b>	<ul style="list-style-type: none"> <li>▪ Inaccurate or conflicting information and comments</li> <li>▪ Out-dated or irrelevant data</li> <li>▪ Facts and opinions intermixed</li> <li>▪ Conclusions and recommendations not supported</li> <li>▪ Poor presentation, spelling and grammatical errors</li> <li>▪ Fancy visual appearance and lack of attention to content</li> </ul>

## Techniques for presenting budget outcomes

When presenting budget outcomes, you will need to consider how you engage with your audience, to ensure the message that you intend to communicate is clearly received.

From time to time, you may need to orally present budget outcomes to team members, senior management, departmental managers or key decision makers.

This could take the form of a management meeting, a whole of finance team meeting, a round-table discussion or a one-to-one conversation.

The following communication techniques will help ensure you communicate effectively with your audience:

### Communication techniques

- Always begin with a brief introduction of the information you are about to present.
- Talk at a moderate pace – not too fast and not too slow.
- Use a respectful, friendly and polite tone of voice.
- Use an appropriate volume so that everyone in the room can hear you.
- Use words your audience can understand and be sure to explain any financial jargon (technical terms) and acronyms.
- Ask open questions to check the audience has understood what you have presented.
- Use your active listening skills when receiving feedback or questions from your audience.

### 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 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 5 per cent for budgeted items up to \$50 000
- any variation of more than 3 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 8

### Question 1

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Provide six guidelines for compiling a written report in relation to budgets and expenditure.

### Question 2

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List four organisational requirements you should be aware of when preparing, lodging and/or authorising financial reports.

## Summary

- 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.
- Approved budgets and relevant information need to be communicated to all relevant employees in a form that is understandable and clearly communicates their budget responsibilities.
  - Dissemination can be in the form of formal meetings, group sessions, written communication, face-to-face presentations or electronic communication.
- People should have sufficient time to study the financial plans and note whether any points they had raised in the developmental phase have been addressed.
- 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.
- Work teams must be supported with the appropriate resources and systems including adequate physical resources, training and effective software systems to achieve the best outcomes for the team and organisation.
- In order to monitor actual expenditure, the various cost items need to be classified as direct materials costs, direct labour costs, overheads with fixed and variable costs.
  - They should be allocated an appropriate cost code corresponding to the chart of accounts.
- Financial performance is reported by comparing budget income and expenditure against actual income and expenditure at defined times, usually monthly.
- Variance reports can be generated for each cost centre so that managers can monitor their performance on income and expenditure in each cost category.
- 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.
- Implemented contingency plans should be reviewed, monitored and adjusted in order that the team or organisation achieves the financial objectives.
- 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 2

### Implement and monitor financial management plans

#### Part A

1. Draw a line to match the beginning of each sentence to the correct ending.

- |                                     |  |
|-------------------------------------|--|
| » Cash flow budgets                 | » record the capital cost of fixed assets, exclusive of GST.   |
| » Fixed asset registers             | » report revenue and expenditure for the year, and exclude GST.  |
| » Electronic spreadsheets           | » should include GST on cash inflows and outflows, where applicable.   |
| » Accounts payable ageing summaries | » include all the controls, policies, procedures and forms used by an organisation to dispense monies for various miscellaneous needs.           |
| » Profit and loss statements        | » are listings, or reports, that outline the due dates of the bills and invoices an organisation needs to pay.                                   |
| » Petty cash systems                | » should be checked regularly for errors and make use of embedded functionality such as password protection, hidden worksheets and locked cells. |

2. How can you effectively communicate budgets and financial plans to team members?  
Tick all that apply.

- Use specific accounting terms and jargon.
- Use verbal and non-verbal communication methods to deliver your message.
- Use active listening skills to concentrate on and understand feedback and questions from team members.
- Use written communication to convey large amounts of information.
- Use closed questions to elicit detailed responses from team members in order to confirm their understanding.

3. List four examples of digital technology resources that could be used by team members to meet ATO record keeping requirements and organisational audit responsibilities.

4. Which of the following statements about organisational and legislative financial requirements are correct? Tick all that apply.

- Organisations with an annual turnover of \$25 000 or more are required to register for GST.
- Throughout the financial year, organisations must lodge activity statements and forward payments to the ATO in accordance with the PAYG system.
- FBT is paid by employers for certain benefits they provide their employees.
- GST reporting requirements include accounting for GST on all taxable sales and supplies (one-eleventh of the total sale price) and accounting for and claiming GST paid on all taxable purchases (one-eleventh of the total purchase price).
- Generally, organisations must retain written evidence for ten years from the date they lodge a tax return.

5. Which of the following statements about organisational budget and expenditure reports are correct? Tick all that apply.

- Project reports may be requested from higher authorities or initiated in response to a particular situation or issue.
- Reporting protocols should cover report types, report content, report formats and report deadlines.
- Reports can be generated from accounting software or spreadsheet-based records.
- Written reports should contain a balance of facts and opinions.
- When presenting reports, ask open-ended questions to check the audience has understood what you have presented.

## Part B

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

### Case study

Rosie is the Area Manager for a national clothing retailer in Australia. She oversees the operations of six retail outlets located across the eastern states.

Rosie's responsibilities include monitoring retail sales and expenditure for her region. She must ensure that all six retail outlets are contributing to the organisation's financial objectives by meeting monthly sales targets and expenditure budgets.

Rosie is feeling troubled, following a disappointing start to the new financial year. Total operating expenditure across all stores in Rosie's area exceeded budget by more than 25 per cent. Rosie is concerned that all of her store managers have budget responsibilities, yet have had very little financial training.

As a result, Rosie reviews the current budget development and review process. Rosie meets with the human resources manager and finds there has been relatively little formal training carried out in relation to budgets and financial management.

Rosie's research leads her to believe that store managers do not take a proactive approach to monitoring, controlling and reporting on store expenditure, which she attributes to their lack of training. To address these concerns, Rosie calls a team meeting with her store managers to provide them with extra training in financial management.

Rosie would also like to re-visit some of the stores' contingency response plans, to ensure they are still relevant, in particular the stores' decision to hold greater quantities of stock in the event of a stock shortage. She is concerned about the increased inventory carrying costs of such a decision.

1. List at least four key items Rosie should cover when discussing monitoring store expenditure with her store managers.

2. What cost controls could Rosie implement, given the unfavourable variance in all stores' operating expenditure for the month of July? Tick all that apply.

- Ask team members to provide options and input for reducing costs.
- Make additional savings through resource sharing across stores.
- Carry out succession planning.
- Put a stop to non-essential expenditure and redirect funds to areas of cost blowout.
- Reduce travel expenditure by limiting travel between interstate stores and employing other communication methods such as videoconference calls.

3. Why is it now critical for Rosie to review and modify the stores' contingency response plan for stock shortages? In your answer, suggest an alternative contingency response plan for stock shortages.



## Topic 3 | Review and evaluate financial management plans

- 3A Collect information for analysis
- 3B Analyse variances and recommend improvements
- 3C Implement and evaluate agreed improvements

## 3A Collect information for analysis

Data from operating activities must be systematically collected, analysed and recorded in order to assess the effectiveness of an organisation's financial management plans and processes.

The data and information gathered must be accurate. Incorrect data or information can lead to 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 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 information

Information collection needs to be systematic, so make sure there is a system in place for collecting, storing and extracting the various records and information you need.

The objective of collecting information is to consider how well the financial management processes are working.

- 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, do changes need to be made to staffing, suppliers, tender processes, outsourcing or waste management processes?

When information is collected, it is important that the data is appropriately collated to 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 affect 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 particular 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 the relevant data collected so that it can be collated to accurately reflect the whole department.

## Source documents

**Source documents provide evidence that a particular business transaction has taken place.**

It is important to file or store source documents appropriately so that they are easily retrievable at a later date to verify transactions and help establish the effectiveness of financial management processes.

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

<b>Bank account records</b>	<ul style="list-style-type: none"> <li>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.</li> </ul>
<b>Contracts</b>	<ul style="list-style-type: none"> <li>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.</li> <li>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.</li> </ul>
<b>Credit card receipts</b>	<ul style="list-style-type: none"> <li>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.</li> </ul>
<b>Insurance reports</b>	<ul style="list-style-type: none"> <li>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.</li> </ul>
<b>Invoices</b>	<ul style="list-style-type: none"> <li>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.</li> </ul>
<b>Job costing reports</b>	<ul style="list-style-type: none"> <li>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.</li> <li>Job costings are used to develop invoices on completion of the job and therefore have a direct impact on appropriate invoicing. A job that has been incorrectly costed implies incorrect invoicing.</li> </ul>
<b>Petty cash receipts</b>	<ul style="list-style-type: none"> <li>Receipts submitted for petty cash claims are a record of expenditure and should be recorded in the accounting system against the relevant area and cost code.</li> </ul>
<b>Quotations</b>	<ul style="list-style-type: none"> <li>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.</li> </ul>
<b>Taxation records</b>	<ul style="list-style-type: none"> <li>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.</li> </ul>

<b>Payroll records</b>	<ul style="list-style-type: none"> <li>▪ Employee time sheets constitute the source document for the calculation of 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.</li> <li>▪ 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.</li> <li>▪ Allowances and deductions are also recorded. These are legislative deductions such as PAYG withholding and voluntary deductions such as union fees.</li> <li>▪ 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.</li> </ul>
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## Performance and analysis reports

Specific performance and analysis reports can be used to establish the effectiveness of financial management processes within the work team and wider organisation.

Performance and analysis reports should be collected and reviewed on a regular basis to determine whether individuals, teams and departments are contributing to organisational goals.

It is important that you are aware of your organisation's policies and procedures as well as the roles and responsibilities set out in your job description, when collecting, sharing and storing financial performance information. Some information could be highly confidential, so you must ensure that you adhere to company requirements when communicating information to team members.

Performance and analysis reports that can be used to evaluate financial performance include:

- key financial statements such as profit and loss statement and balance sheet to view the financial health of the business
- aged debtors' summary to determine effectiveness of the accounts receivable team's credit management and debt collection policies
- inventory records to determine effectiveness of inventory controls
- working capital statements and financial ratios to evaluate business performance and compare it with others in the same industry
- variance analysis reports to determine which operating costs have exceeded budget
- cash flow statements to evaluate how effectively the business is managing its cash resources
- analysis of overheads to determine whether overheads are being controlled effectively or whether they are reducing the overall profitability of the business.

## Example

### Collect and check information

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

- time sheets for casual and part-time workers in hard copy against payments 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 9

### Question 1

Summarise three key considerations when collecting information on the effectiveness of financial management processes.

## Question 2

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List six examples of performance and/or analysis reports that can be used to review and evaluate the financial performance of work teams.



## 3B Analyse variances and recommend improvements

When analysing source documents and reports, confirm whether you have managed the financial resources in accordance with the budget plans as well as organisational policies and procedures.

This means checking to see whether the team has been able to meet its budget and, if not, analysing information to identify:

- inaccuracies in documents that have led to incorrect conclusions and reporting
- circumstances that have accounted for cost variations and expenditure overruns in the budget.

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, an 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. Regardless of the size of the company or its turnover, the analysis must be carried out thoroughly.

The manager must ensure that staff:

- 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.

## Check source documents

Where an analysis suggests there are unexpected variations from the budget, it is important to consider the source data and information used to generate that report.

Drilling down into the original source data to verify the position being reported can provide vital information that explains the reasons for the variation. When discrepancies are found between source documents and how they have been entered into accounting systems, corrective action is required to fix 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.

## Analyse budget variations

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

When analysing financial data, it is important to separate and distinguish the main elements contained within the financial reports. By doing so you may come across significant issues which will need to be considered and addressed.

The two commonly used techniques for identifying significant issues in an organisation's operations, are budgetary analysis and horizontal analysis.

## Budgetary analysis

Budgetary analysis is a financial analysis technique, used to detect significant issues in an organisation's business operations, by reviewing budgeted data against actual costs.

It helps to understand why fluctuations happen and what can be done to reduce any significant variances. It also helps budgeters get a more realistic picture, in order to prepare more accurate budgets for the coming year.

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.

### Example

#### Budgetary analysis

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 discount.
- Two new staplers that were not budgeted for were purchased to replace broken equipment.

For the salary and wages, the variance is 2.5 per cent; in the bigger picture, this is not a high variance but at the end of the year could represent an \$8000 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 5 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.

## Horizontal analysis

Horizontal analysis is another financial analysis technique that looks at the relationship between items, or groups of items, in the financial reports across consecutive accounting periods.

It looks at historical data and considers how things have changed from one accounting period to the next.

By comparing the actual changes in items with the changes expected over time, management can identify which items require further investigation and make important business decisions based on their findings.

Most large organisations provide horizontal analysis as part of their annual reporting requirements.

### Example

#### Horizontal analysis

The following comparative statement shows operating expenses for the two years ending 30 June 2019 and 2020.

Comparative operating expenses statement				
For years ended 30 June 2019 and 2020				
	2019	2020	Variance	
	(\$)	(\$)	(\$)	(%)
Accounting fees	57 600	56 500	1 100	1.95
Advertising	25 200	24 800	400	1.61
Electricity	10 680	11 120	-440	-3.96
Insurance	2 000	8 500	3 500	41.17
Licences	2 760	2 650	110	4.15
Office expenses	18 000	17 910	90	0.50
Rates and taxes	10 680	9 980	700	7.01
Repairs and maintenance	7 200	8 300	-1 100	-13.25
Salaries and wages	37 200	39 100	-1 900	-4.86
Waste removal	4 440	4 250	190	4.47
<b>Total</b>	<b>\$185 760</b>	<b>\$183 110</b>	<b>+\$2 650</b>	<b>+1.44</b>

### Horizontal analysis continued...

When reviewing and analysing the financial data above, you will notice that the insurance expense has decreased significantly from one financial year to the next and will require further investigation as to the possible causes.

Depending on management's findings, it may influence their decision regarding whether to stay with the current insurer or find a new one.

## Circumstances responsible for budget variations

The four primary causes of budget variance include errors, timing, changing business conditions and unmet business expectations.

If current data is not entered into accounting systems correctly, or in a timely manner, you may find a report is based on incorrect and 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.

Changing business conditions, such as economic factors, increasing costs, political or regulatory changes and the introduction of a new competitor could be responsible for budget variances.

Unmet business expectations also contribute to budget variances; for example, teams that fail to achieve key performance indicators. These results could highlight skills gaps, under-performing individuals and the need for additional training. Unmet business expectations can also arise if the budget was simply unrealistic and unachievable from the outset.

Source documentation would provide an initial insight into circumstances that have changed, thus creating variances to budget. An awareness of global trends, competitor activity and legislative changes would also provide valuable insight.

Source documents used to identify budget variations are outlined below:

Source documentation may assist with identifying reasons for budget variations	
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.
Job costings	Incorrectly estimated job costings result in cost overruns and lower-than-appropriate charges to customers.
Labour costs	Changes in labour costs due to changes in personnel result in variations to salary and wages that are different to the budgeted amounts.
Cost of supplies	Increases in the cost of supplies may be due to price rises from the supplier.
Overtime costs	Increased overtime costs that can be attributable to absences due to illness or increased demand for products and services.
Data processing	Delayed processing of source data onto the financial system may result in incorrect reports.

### Example

#### Identifying errors

A data entry error occurred when an insurance premium of \$1500 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, the cost centre manager received a variations report before reconciliation took place, suggesting that his budget for insurance had been overspent for the year by more than 500 per cent.

## Identify improvements

**When a budget period shows the team is underperforming, managers need to carefully analyse results to identify areas where improvements can be made.**

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 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.

Once you have analysed the data 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 and invite their feedback.

When identifying improvements to existing financial management processes, it's helpful to ask yourself the questions described below:

#### Key considerations when assessing effectiveness of financial management processes

- How effectively are we matching goods and services to our customers' needs?
- Which products and services are performing as expected?
- Which products and services aren't performing as planned?
- What's really behind the problems of a product or service?
- Are costs being reviewed frequently?
- How do we compare with our competition?
- Do we have the right people, with the right skills, to achieve organisational objectives?

## Recommend improvements

Occasionally, financial improvements and recommendations will need approval from key decision makers, such as senior management, the board of directors, shareholders or the Chief Executive Officer.

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

Examples of recommended improvements to existing financial management processes could include:

- more frequent monitoring and reporting of costs
- increasing accounts receivable turnaround time
- outsourcing operations
- implementing rolling budgets and forecasts
- better software integration or
- earlier communication when issues arise.

Your recommendations should make it easy for the key decision makers to understand what changes should be implemented. All financial business recommendations need to be concise and provide clear direction regarding the organisation's financial resources.

#### Techniques for providing considered financial business recommendations

- Keep recommendations short and brief.
- Focus on objective evidence and financial data.
- Avoid puffery.
- Avoid non-essential information.
- Provide clear evidence to support your recommendations.

## Communication methods

The way you communicate financial recommendations with key decision makers will vary according to time constraints, their needs and interests in the matter, location and the structure of the organisation.

Based on the level of importance and impact of a financial recommendation, it will generally be more practical to schedule a face-to-face or video/web meeting to present your recommendations. Routine procedures such as communicating via email could be considered inappropriate if you are working in the same vicinity as your key decision makers.

Alternatively, a written report may be required to assist with the interpretation of financial data and to document your business recommendations.

For communication to be effective, it needs to be two-way. This allows both you and your audience to give and receive useful information and confirm understanding.

You need to give your key decision makers the opportunity to seek clarification by asking questions and have input into the details of your financial recommendations. It is important that you respond to and clarify any questions with clear, concise answers.

Communication skills for finance personnel	
Attentiveness	Listening and being receptive
Flexibility	The ability to compromise when necessary to achieve the organisation's goals
Discretion	The ability to make wise decisions about which topics are private or confidential
Enthusiasm	A willingness to advance the organisation with a positive outlook
Empathy	Showing sensitivity towards what key decision makers are thinking and feeling
Judgement	Being able to make appropriate decisions
Diplomacy	Tactfully handling a delicate situation

## Example

### Detecting 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 the reports produced at the end of the second quarter have not included some significant expenditure, and 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 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.

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, 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 10

### Question 1

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Describe how each of the following variance analysis techniques is used to review and evaluate financial management processes.

- Budgetary analysis
- Horizontal analysis

### Question 2

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How do you identify improvements to existing financial management processes?

### Question 3

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When recommending improvements to key decision makers, what principles should you follow? Tick all that apply.

- Communicate recommendations in a concise and effective manner.
- Provide evidence to support your recommendations.
- Use one-way communication methods.
- Communicate all recommendations via email first.
- Focus on objective evidence and financial data.

## 3C Implement and evaluate agreed improvements

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Any recommended improvements need to be agreed upon and approved by authorised personnel. Once approved, they should be implemented and evaluated to ensure they are improving processes.

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

Examples of improvements include:

- adjusting product design that requires fewer 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 improvements

The method for implementing improvements in an organisation depends on the size and complexity of the improvements required.

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.

Before implementing improvements, it is important to document new processes in a process improvement plan. These can be used to help employees at all levels, including key decision makers, quickly understand and implement new company processes.

How to document process improvement plans	
Step 1	Identify and name the process.
Step 2	Identify the results the new process will achieve.
Step 3	Identify the timelines in which the new process is to be achieved.
Step 4	Identify what resources are necessary to carry out the new process.
Step 5	Outline who is involved.
Step 6	Determine the steps required to carry out the new process.
Step 7	Establish measurements or indicators to determine the effectiveness of the new process.

## Evaluate improvements

Successful implementation is underpinned by effective monitoring, review and evaluation processes.

It is essential to determine what successful outcomes will look like and what evidence will be needed to demonstrate success.

Effective review and evaluation processes involve monitoring progress towards the objectives, conducting regular reviews, evaluating outcomes, reporting to others and involving relevant stakeholders.

Techniques for monitoring and evaluating outcomes are listed below.

- Supervise teams and individuals.
- Seek ongoing feedback from team members, management or customers.
- Conduct surveys with customers.
- Periodically assess progress, efficiency, performance, impact and relevance.
- Engage in direct observation.
- Conduct interviews and focus groups.
- Benchmark with similar organisations.
- Regularly conduct variance analyses.
- Regularly conduct trend analyses.

The process for monitoring a twofold implementation of improvements is shown below:

### Monitoring implementation

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

### Monitoring post-improvement

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

## Example

### Improving processes

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 the plumbers should have a simple form that can be used to record the date, place of purchase and job number on a sheet; and attach the receipt from the supplier. These sheets are to be given to Grace on the last day of each week, when the plumbers come into the office to collect the job details and any supplies 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

### Improving the 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 incurred is always late. Currently, consultants out at sites use their own resources to purchase needed items and complete the 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 she generates are not accurate; they do not contain all expenditure for the preceding month because consultants, many of whom are interstate, are not sending it in on time.

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

## Practice Task 11

### Question 1

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Describe three steps you should take, before implementing and after implementing improvements to financial management processes.

### Question 2

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How could you evaluate the effectiveness of agreed improvements? Tick all that apply.

- Analyse budgets to identify favourable variances.
- Obtain feedback from team members.
- Wait until the end of the financial year to discuss positive and negative outcomes.
- Conduct regular assessment of progress, efficiency, performance, impact and relevance.
- Supervise team members.

## Summary

- 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.
- Timely collection and collation of data and information is a critical function for an organisation if it is to produce accurate reports.
- Data and information gathering needs to be accurate, reliable, free from errors and be presented in accordance with organisational and statutory requirements, such as designated time frames, formats and required content.
- Source documentation should be reconciled against the various accounts to verify accuracy of data and information on the system.
- Incorrect reports or analysis lead to inaccurate budgeting processes, affecting the organisation's ability to deliver on the team and organisational objectives.
- Performance reports on the effectiveness of the financial management processes should be analysed, with changes identified that can improve existing financial management processes.
- Recommended improvements need to be approved, implemented and evaluated to ensure they are effective and assist the team to achieve its financial objectives.

## Learning Checkpoint 3

### Review and evaluate financial management plans

#### Part A

1. Which of the following records can be used to review and evaluate the financial performance of work teams? Tick all that apply.

- Aged debtors' summary
- Memorandum of fees
- Profit and loss statement
- Records of employee bonuses
- Variance analysis report

2. What techniques should you use when presenting recommendations or improvements to key decision makers? List at least five.

3. List five techniques that can be used to evaluate agreed improvements.

## Part B

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

### Case study

Rosie is the area manager for a national clothing retailer in Australia. She oversees the operations of six retail outlets located across the eastern states.

Rosie's responsibilities include monitoring retail sales and expenditure for her region. She must ensure that all six retail outlets are contributing to the organisation's financial objectives by meeting monthly sales targets and expenditure budgets.

It is the first week of October and Rosie is reviewing each store's quarterly results. Rosie is relieved to see that sales at Store A have exceeded budget by 6.3 per cent.

Rosie conducts further analysis of Store A's results, by comparing operating expenditure against budgeted expenditure. In accordance with her organisation's policies and procedures, Rosie must investigate all favourable and unfavourable budget variances that are greater than 10 per cent.

Rosie is required to report to the Board within 14 days, when budgeted and actual spend differ by more than 10 per cent.

In her report, she must include a summary of the circumstances leading to the favourable or unfavourable variance, and recommended improvements where the variance is unfavourable.

1. Analyse the incomplete profit and loss variance report below, then answer the question that follows. (You will need to perform your own mathematical calculations to answer the question.)

Store A					
Profit and loss variance report					
for 3 months ending 30 Sep 2019					
Item	Budget (\$)	Actual (\$)	Variance (\$)	Variance (%)	Fav/Unfav
Income					
Sales	155 000	164 832	9 832	6.3%	F
Gross profit	155 000	164 832	9 832	6.3%	F
Expenditure					
Salaries	18 000	18 480			
Marketing & sales	10 000	10 101			
Administration	6 000	9 020			
Electricity	7 000	7 213			
Repairs & maintenance	5 000	5 250			
Purchases	20 000	21 120			

Store A Profit and loss variance report for 3 months ending 30 Sep 2019					
Item	Budget (\$)	Actual (\$)	Variance (\$)	Variance (%)	Fav/Unfav
Rent	35 000	35 000			
Outgoings	7 000	7 000			
Cleaning	8 000	9 890			
Security	6 000	5 913			
Licences	3 000	2 380			
Storage	5 500	5 500			
Subscriptions	4 000	3 875			
Total operating expenses	134 500	142 342			
Net profit	20 500	22 490			

2. Which three operating expenses require further investigation by Rosie? Provide the variance for each by completing all cells in the table below.

Operating expense	Budget (\$)	Actual (\$)	Variance (\$)	Variance (%)	Fav/Unfav
1.					
2.					
3.					

3. What possible circumstances may have led to these significant variances? Tick all that apply.

- Human error when recording expenditure
- Increased competitor activity
- Timing of recording expenditure
- Changing conditions in supplier contracts
- Recruitment of additional staff at Head Office

4. List four key groups or personnel that Rosie should consult with, when identifying improvements to existing financial management processes.

5. What approach should Rosie take when implementing improvements to existing financial management processes? Tick all that apply.

- Seek approval from key organisational personnel.
- Document and distribute process improvement plan to store managers.
- Assume all store managers understand their roles and responsibilities.
- Confirm store managers have appropriate training and resources to carry out new processes.
- Ensure organisational and financial objectives are upheld.

6. After thorough analysis, Rosie established that the unfavourable variances arose due to human error when entering expenditure into the accounting software system. Recommend two improvements that Rosie could implement.



