



UNIT 13: MANAGING FINANCIAL PRINCIPLES AND TECHNIQUES

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- LO 2 : BE ABLE TO APPLY FORECASTING TECHNIQUES TO OBTAIN INFORMATION FOR DECISION MAKING

THE BASIC SYLLABUS

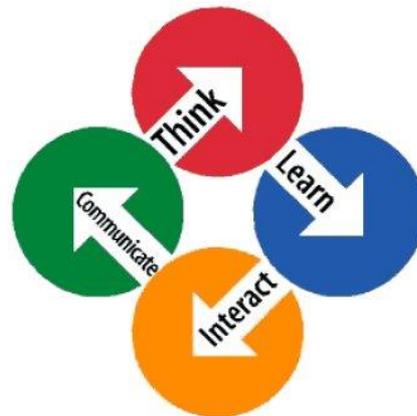


- 1. Be able to apply cost concepts to the decision making process.
- 2. Be able to apply forecasting techniques to obtain information for decision making.
- 3. Be able to participate in the budgetary process of an organisation.
- 4. Be able to recommend cost reduction and management processes for an organisation.
- 5. Be able to use financial appraisal techniques to make strategic investment decisions for an organisation.
- 6. Be able to interpret financial statements for planning and decision making.

LEARNING OBJECTIVES



- Be able to participate in the budgetary process of an organisation



- At the end of the class the students should be able to:-
- Evaluate budgetary monitoring processes in an organisation.

OVERVIEW



- The budget monitoring process serves two primary purposes:
- 1) monitoring of current and prior year expense and revenue budgets
- and
- 2) adjusting the current fiscal year's budget.
- Adjustments to the current fiscal year's budget are done both to reflect changing conditions as well as to appropriate carryover from prior years.

BUDGETED AND ACTUAL FIGURES



- Companies base budgets on historical numbers, similar processes and calculated values. The budgets predict costs and revenues over a fixed period into the future. Once the budget period is finished, the company can determine actual costs and revenues as it books sales and pays invoices. It assigns the actual values to the same cost and profit centers it used for the budget, and it can compare the budgeted numbers with the actual figures.

ACCOUNTING FOR AND INVESTIGATING VARIANCES



- A variance is defined as the difference between the actual amounts and the standard amounts. Variance can be calculated for both costs and revenues. Variance analysis in managerial accounting is basically associated with the outcome of the planned and actual results and the effects of their differences among the routine performance of a person, article, or a company. Therefore it is very useful in management and accounts and also in calculating labor and materials costs.

ACCOUNTING FOR AND INVESTIGATING VARIANCES



- A **debit balance in a variance account** indicates an unfavorable variance.
- • A **credit balance reflects a favorable variance**, indicating that actual costs were less than the standard.

ACCOUNTING FOR AND INVESTIGATING VARIANCES



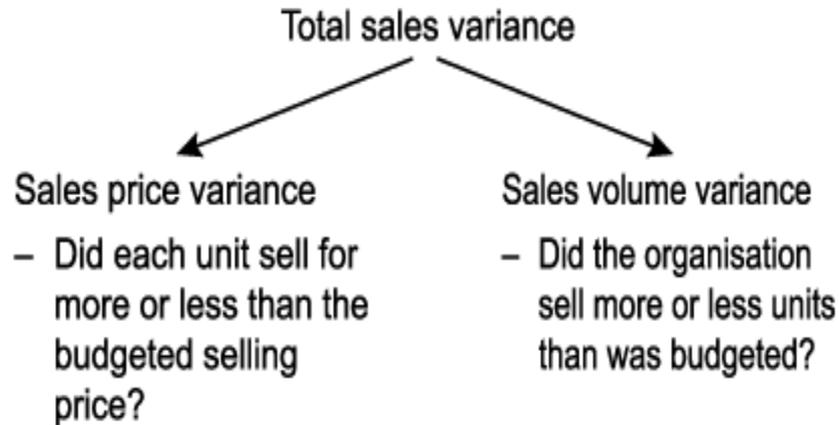
- Variance analysis better informs managers about current business operations. Knowing what has performed and what has not, managers can take reinforcing measures or corrective actions. The purpose of comparing actual vs. budget is to add value to the business through better planning, monitoring, evaluating and controlling. Management may adjust a budget upward or downward to better reflect reality and implement new cost-cutting or sales-promoting measures.

FAVOURABLE AND ADVERSE VARIANCES



- A number of basic variances can be calculated. If the results are better than expected, the variance is favourable (F). If the results are worse than expected, the variance is adverse (A).
- It is important to be able to:
 - 1.calculate a variance
 - 2.explain the meaning of the variance calculated
 - 3.identify possible causes for each variance.
- Once the variances have been calculated, an operating statement can be prepared reconciling actual profit to budgeted profit, under marginal costing or under absorption costing principles.
- Basic variances can be calculated for sales, material, labour, variable overheads and fixed overheads.
- Each of these will be reviewed in turn

FAVOURABLE AND ADVERSE VARIANCES

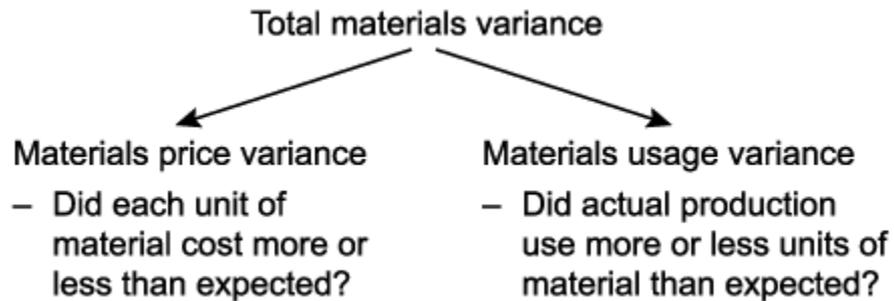


FAVOURABLE AND ADVERSE VARIANCES



Causes of material variances		
Variance	Favourable	Adverse
Material Price	<ul style="list-style-type: none"> •Poorer quality materials •Discount given for buying bulk •Change to a cheaper supplier •Incorrect budgeting 	<ul style="list-style-type: none"> •Higher quality materials •Change to a more expensive supplier •Unexpected price increase encountered •Incorrect budgeting
Material Usage	<ul style="list-style-type: none"> •Higher quality materials •More efficient use of material •Change is product specification •Incorrect budgeting 	<ul style="list-style-type: none"> •Poorer quality materials •Less experienced staff using more materials •Change is product specification •Incorrect budgeting

FAVOURABLE AND ADVERSE VARIANCES

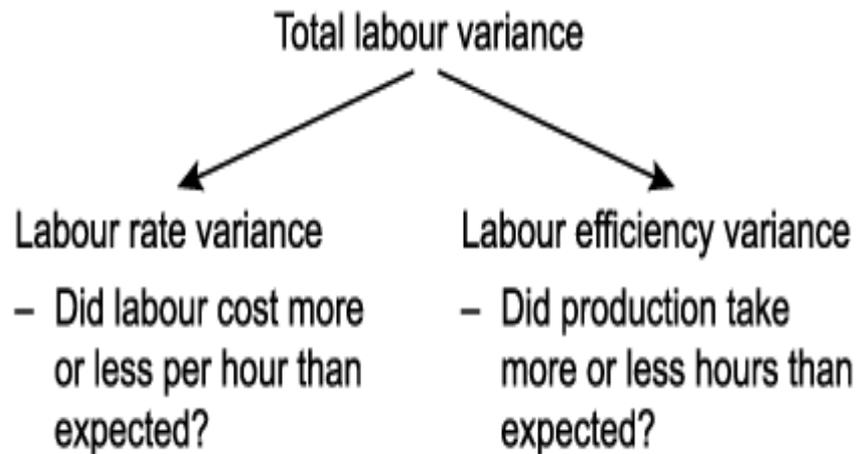


FAVOURABLE AND ADVERSE VARIANCES



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FAVOURABLE AND ADVERSE VARIANCES

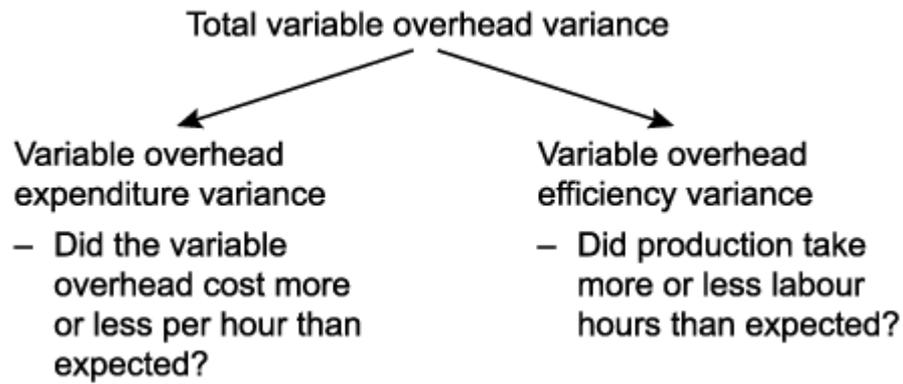


FAVOURABLE AND ADVERSE VARIANCES



Causes of labour variances		
Variance	Favourable	Adverse
Labour rate	<ul style="list-style-type: none">• Lower skilled staff• Cut in overtime/bonus• Incorrect budgeting	<ul style="list-style-type: none">• Higher skilled staff• Increase in overtime/bonus• Incorrect budgeting• Unforeseen wage increase
Labour efficiency	<ul style="list-style-type: none">• Higher skilled staff• Improved staff motivation• Incorrect budgeting	<ul style="list-style-type: none">• Lower skilled staff• Fall in staff motivation• Incorrect budgeting

FAVOURABLE AND ADVERSE VARIANCES

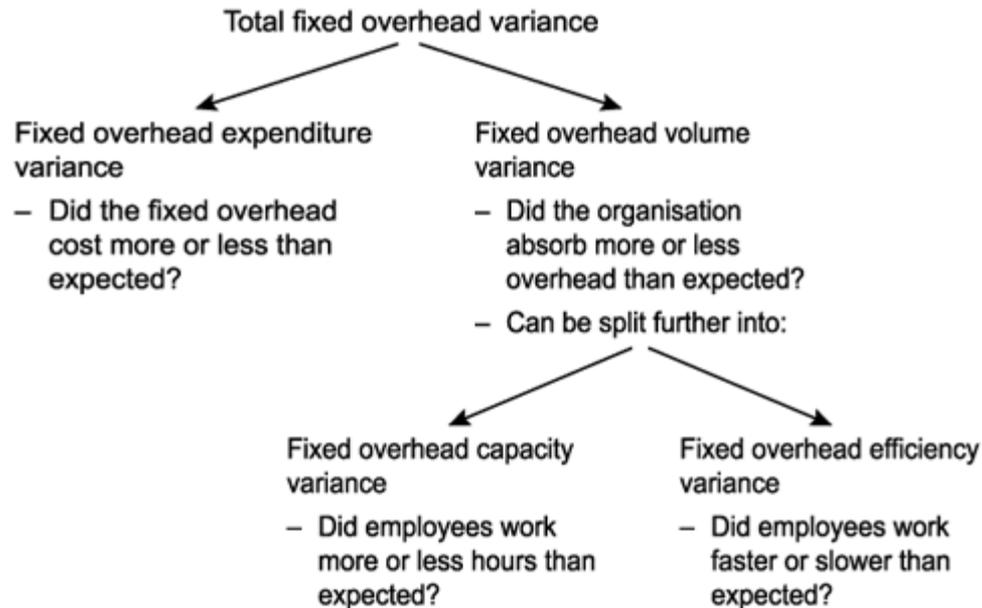


FAVOURABLE AND ADVERSE VARIANCES



Causes of variable overhead variances		
Variance	Favourable	Adverse
Var. o/h expenditure	<ul style="list-style-type: none"> •Unexpected saving in cost of services •More economic use of services •Incorrect budgeting 	<ul style="list-style-type: none"> •Unexpected increase in the cost of service •Less economic use of service •Incorrect budgeting
Va. o/h efficiency	<ul style="list-style-type: none"> •As for labour efficiency 	<ul style="list-style-type: none"> •As for labour efficiency

FAVOURABLE AND ADVERSE VARIANCES



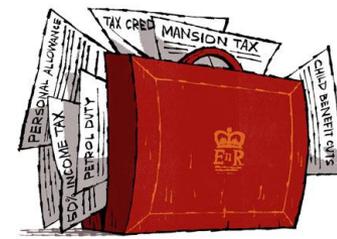
FAVOURABLE AND ADVERSE VARIANCES



Causes of fixed overhead variances		
Variance	Favourable	Adverse
Fixed o/h expenditure	<ul style="list-style-type: none"> •Decrease in price •Seasonal effects 	<ul style="list-style-type: none"> •Increase in price •Seasonal effects
Fixed o/h volume	<ul style="list-style-type: none"> •Increase in production volume •Increase in demand •Change in productivity of labour 	<ul style="list-style-type: none"> •Decrease in production volume •Decrease in demand •Production lost through strikes
Fixed o/h capacity	<ul style="list-style-type: none"> •Hours worked higher than budget 	<ul style="list-style-type: none"> •Hours worked lower than budget
Fixed o/h efficiency	<ul style="list-style-type: none"> •As for labour efficiency 	<ul style="list-style-type: none"> •As for labour efficiency

THE NEED FOR PROMPT AND RELEVANT CORRECTIVE

ACTION



- A good reporting system should only report on exceptions. "Nothing to report " is an acceptable comment when figures are on or near budget. If they are not then the reviewer will need to know:
 - 1. What is the cause and will it happen again
 - 2. What is the financial effect
 - 3. What is being done or to be done
 - 4. Are there implications for other managers

BEHAVIOURAL ISSUES



RELATING TO BUDGETING

- Budgeting is a method of communicating the goals of the organisation to the appropriate managers in order to facilitate, coordinate and control various sections of the organisation so that the desired outcomes are achieved.
- It is important for managers to develop attitudes and strategies that cultivate and maintain supportive and cooperative relationships with subordinates. Budgets must not only be used as a computational tool to control costs: the behavioural aspects must also be considered so that staff will be motivated enough to achieve the budget's goals. This can only be done if staff have a sense of ownership of the budget.

PERFORMANCE EVALUATION



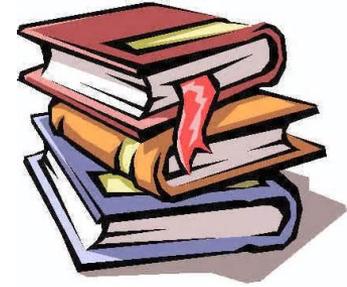
- An employee evaluation is the assessment and review of a worker's job performance. Most companies have an employee evaluation system wherein employees are evaluated on a regular basis (often once a year). The performance evaluation process in organizations is ongoing - every day - as the manager or supervisor observes and coaches each employee's performance.

PERFORMANCE EVALUATION



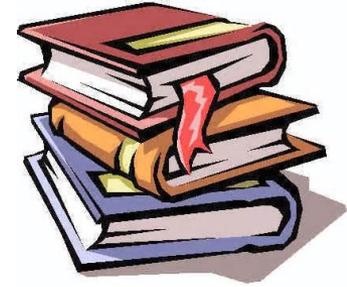
- In many organizations with a formal employee evaluation process, employees are ranked and rated in comparison to other employees. Rates are assigned based on both the evaluation ranking and the rating - usually 1-5 - that the manager assigns to the employee's performance.

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