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:-
- Participate in the creation of a master budget of an organisation.

OVERVIEW

- Budgeting for a business is a process. It is the process of preparing a detailed statement of financial results that are expected for a given time period in the future. There are two keywords in that statement. The first keyword is "expected." Expected means something that is likely to happen. The second keyword is "future" which is a period in the time to come. So, budgeting is the process of preparing a detailed statement of financial results that are likely to happen in a period in a time to come.

Importance to Management

- Simply put, a budget is an itemized summary of likely income and expenses for a given period. It helps you determine whether you can grab that bite to eat or should head home for a bowl of soup. It is typically created using a spreadsheet, and it provides a concrete, organized, and easily understood breakdown of how much money you have coming in and how much you are letting go. It's an invaluable tool to help you prioritize your spending and manage your money—no matter how much or how little is available.

Importance to Management

- The purpose of budgeting includes the following three aspects:
- A forecast of income and expenditure (and thereby profitability)
- A tool for decision making
- A means to monitor business performance

IMPORTANCE TO MANAGEMENT

- Forecast of income and expenditure

- Budgeting is a critically important part of the business planning process. Business owners and managers need to be able to predict whether a business will make aprofit or not. The purpose of budgeting is basically to provide a model of how the business might perform, financially speaking, if certain strategies, events, plans are carried out.
- In constructing a Business Plan, the manager attempts to forecast Income and Expenditure, and thereby profitability.

IMPORTANCE TO MANAGEMENT

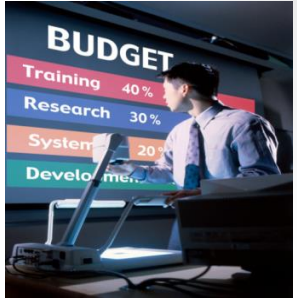
- Tool for decision making
- The purpose of budgeting is to provide a financial framework for the decision making process i.e. is the proposed course action something we have planned for or not.
- In managing a business responsibly, expenditure must be tightly controlled. When the budget for advertising has been fully expended, the decision on "can we spend money on advertising" is likely to be "no".

Importance to Management

- Monitoring business performance

- The purpose of budgeting is to enable the actual business performance to be measured against the forecast business performance i.e. is the business living up to our expectations.
- In the figure opposite, "variance" is the difference between budgeted expenditure and actual expenditure.

THE STEPS IN THE PROCESS FROM SUBSIDIARY/FUNCTIONAL TO MASTER BUDGET



- **Setting Objectives**
- Before figuring out the company's budget, the budgeting committee or other key decision makers must set objectives for the future of the company. Objectives could include cost savings, for example, which would require a very different form of budgeting than objectives for expanding a company to a second location.

THE STEPS IN THE PROCESS FROM SUBSIDIARY/FUNCTIONAL TO MASTER BUDGET

- **Determining Available Resources**
- A business's objectives should influence the budgeting process but certainly should not dictate it entirely. A business also must analyze available resources and determine what it has available to reach its objectives. Indeed, the available resources may dictate, to a large extent, the company's objectives. Available resources are not limited to the cash the company has available but also could include potential loans or additional outside investment. Additionally, a company must consider its sales projections for the coming year.

THE STEPS IN THE PROCESS FROM SUBSIDIARY/FUNCTIONAL TO MASTER BUDGET

- **Projecting Future Needs**
- A budget is forward looking and requires some amount of estimation. It is obviously impossible to predict with perfect accuracy what your organization's future budgetary needs will be. There are, however, some important sources of data you can look at to reach an estimate. These sources include past company data, any available data on competitors and an analysis of current and developing economic and regulatory trends that may make the coming year different in any way from previous years.

THE STEPS IN THE PROCESS FROM SUBSIDIARY/FUNCTIONAL TO MASTER BUDGET

- **Match Future Needs to Available Resources**
- More often that not, your available resources will not fit perfectly with your projected future needs. It is at this phase of the budget cycle that you may need to do some compromising and negotiating among your departments to determine how best to allocate your company's scarce resources. You must keep the business's priorities and strategic needs in mind when going through this process.

THE STEPS IN THE PROCESS FROM SUBSIDIARY/FUNCTIONAL TO MASTER BUDGET

- **Obtaining Final Approval**
- Once you have a complete budget worked out, the next step is to acquire approval from the budgeting committee or whatever entity is empowered to make the final yes or no decision on your budget. The more rigorously you have worked to address the needs of all of the key stakeholders during the previous steps, the smoother this process should be.

THE STEPS IN THE PROCESS FROM SUBSIDIARY/FUNCTIONAL TO MASTER BUDGET

- **Distributing the Approved Funds**
- Once the budget has been finalized and approved, the final step of the budgeting process is to distribute the allocated funds to the various departments and business segments. Typically this is the duty of a chief financial officer or company controller.

THE STEPS IN THE PROCESS FROM SUBSIDIARY/FUNCTIONAL TO MASTER BUDGET

- **Monitoring and Evaluating**
- Once the budget has been finalized and the funds distributed, the budgeting process is not over. You should still actively track the success of the budget you have created and implemented. Look for areas where resources are lacking or where waste seems to exist and keep these areas in mind for future budget cycles.

RESOURCE UTILISATION AND PROFITABILITY

- To improve overall profitability of the organisation, it is critical to achieve more out of fewer resources as resources are major cost to the organisation. In other words it is important to maximise the utilisation of your existing resources. This becomes further crucial in case of human resources, who are major overhead in most of the industries around the world. Any improvement in human resource utilisation adds directly to the bottom line of the organisation and provides required competitive edge against its competitors. Human resource utilisation can be improved by planning and scheduling your resources efficiently and smartly. Traditionally this work is done manually or using resourcing spreadsheet or calendaring tools. These methods are no more efficient and responsive in the environment, where business dynamics are changing often.

RESOURCE UTILISATION AND PROFITABILITY

- To improve long term profitability, it is critical to forecast future human resource requirements in line with future workload and long term corporate objective. This helps the company in recruiting right number of resources at right time in future, reorganise the workforce and retrain existing resources with new set of skills.

COMPUTER ASSISTED PROCESSES

- Powerful resource planning and scheduling software can forecast resource requirements based on future workload and future strategic initiative of the company. So it is critical to have right resource planning and scheduling software, which is designed from scratch to manage and achieve improved utilisation of scarce resources.
- Excel spreadsheet can be used in budgetary control, more effectively than using sheet of papers and a calculator. Comparisons can easily be made between budgeted and actual revenue, budgeted and actual expenditure,budgeted and actual projects executed, etc with a view to taking corrective measures (where necessary) and enhance the attaining of organizational objectives.

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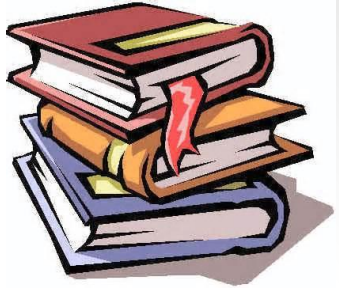

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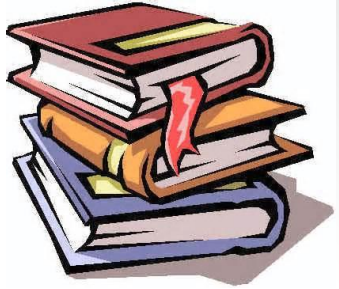

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