TEST FOR PREVIOUS LEARNING MATERIALS UNDERSTANDING

Answer the questions about financial accounting of the enterprise:

1. The specialized branch of accounting that keeps track of a company's financial transactions is named____________________________

2. Each financial transaction that a company makes is recorded by using double entry bookkeeping (TRUE/FALSE)

3. One of the major universal accounting principles is Monetary Unit Assumption. (TRUE/FALSE)

In 5 minutes in one message write your name and answer to the test on the piece of paper or <u>in Zoom chat personally to the teacher</u> (NOT IN COMMON CHAT!!!), and your attendance would be assessed at 0,5 point

FINANCIAL PLANNING &BUDGETING

1. Financial planning of the enterprise
2. Budgeting method
3. Methods of financial planning
4. Organizing of budgeting of the enterprise
5. Constructing the financial structure of the enterprise
6. Main features of budgeting

1. Financial planning of the enterprise

Financial plan is a document describing the tools to achieve the financial goals of the company and balancing income and expenses.

By financial planning:

– the financial goals and guidelines of the company are determined (strategy planning);

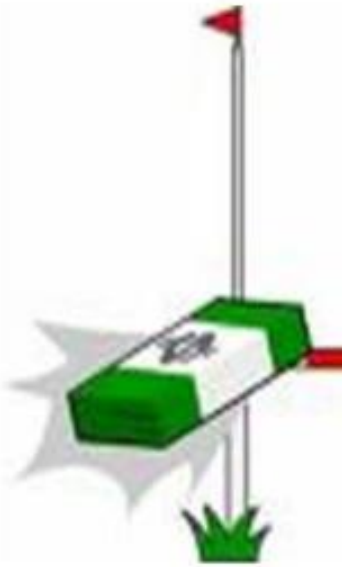
– the compliance of these goals with the current position of the company is established (analysis and forecasting);

– instruments and methods to achieve the objectives are being developed.

Financial plan

- *Long-term* – with the goal: to determine the optimal level of the company’s growth
- *Short-term* – with the goal: to maintain the company’s solvency

Strategic Role of Financial Management



- Goals/Purpose/Mission
- Organisational Objectives
- Strategic Planning
- Tactical Planning
- Operational Planning

Objectives of Financial Management

The objectives of financial management are to maximise a business's liquidity, profitability, efficiency, growth and return on capital.

- Liquidity
  The ability of a business to meet its financial commitments as they fall due.
- Profitability
  Excess of revenue over expenses which a business seeks to maximise
- Efficiency
  The ability of a business to use its resources effectively in ensuring financial stability and profitability.
- Growth

  The ability of a business to increase its size or market share in the long-run.
- Return on Capital
  The amount of profit returned to owners or shareholders as a percentage of their capital contribution.

The goals a business sets are translated into organisational objectives which give a clear indication to management of what the business wants to achieve. The main objective of most business is to make a satisfactory level of profit. This will only occur if it has well defined and achievable goals.

The strategies that an organization adopts work towards achieving its goals – both short and long term ones. Developing a strategic plan as part of an organization's financial management will help guarantee success.

Strategic plans are the most important. They encompass a long-term view of where the business should go and how to get there. In the process, it monitors progress towards its stated goals, making provision for remedial intervention if actual outcomes deviate significantly from the strategic plan.

Managing Financial Resources

Financial resources are those resources of a business that have a monetry value. Financial management is the planning and monitoring of an organisation's financial resources to enable it achieve its financial goals.

The mismanagement of financial resources can lead to problems such as

- Insufficient cash to pay suppliers
- Inadequate capital for expansion
- Too many assets that are not productive
- Delays in accounts being paid
- Misappropriation of funds
- Business failure.

Strategies for monitoring the financial resources of an organization must be incorporated into its strategic plan and should include:

- **Monitoring cash flows and payment of debts**
- **Developing financial control techniques**
- **Auditing of financial accounts**
- **Profit and dividend projections.**

Long-term plans include an organisation’s planned capital expenditure and planned investments. Capital expenditure is spending on non-current assets such as buildings and vehicles. It is used to generate revenue and returns to owners and shareholders. Long-term plans also cover planned sources of finance, spending on research and development, marketing and product development activities.

A business plan might be used when seeking finance or support for a project from a bank or other financial institution or other potential investors. A business plan should set out finance required, the proposed sources of finance and a range of financial statements.

The information contained in a financial plan will be determined by the audience to which it is directed: owners, employees, lenders, potential investors etc.

The Planning Cycle

- The **planning process** involves the setting of goals and objectives, determining strategies to achieve them, identifying and evaluating alternative courses of action and choosing the best alternative.
- Financial planning is essential if a business is to achieve its goals. The financial planning process begins with long-term or strategic financial plans.
- Long-term plans cover a period of between 2 to 10 years. Short-term plans are more specific and cover periods of 1 to 2 years or less.

Financial Planning Process

Stages of financial planning:

– the company's financial situation analysis;

– drawing up forecasting schemes and budgets (income and expense budgets, cash flows);

– calculation of the total financial resources need;

– forecasting the structure of funding sources;

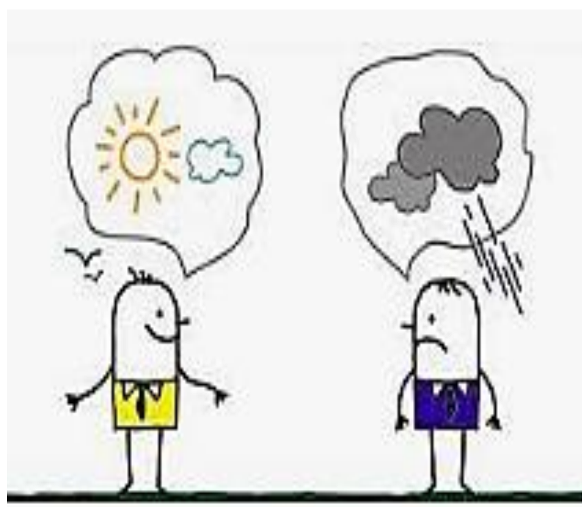
– formation of a control and management system and, if necessary, adjustment of the plan.

In practice, it is recommended to draw up few versions for a financial plan:

– pessimistic;

– the most possible;

– optimistic.



Main sections of financial plan

I. Investment policy:

– fixed capital financing;

II. Working capital management:

– cash flow management;

– inventory financing;

– receivables management.

III. Dividend policy and source structure.

IV. Financial forecasting:

V. Accounting policy.

VI. Management control system.

2. Budgeting method

Budget is the concept narrower than plan. A budget is a quantitative representation of an operational plan in terms of value.

Attribute	Plan	Budget
Indicators & Ratios	Any, including non-quantitative	Mostly cost
Planning period	Depending on the goals of the plan	Usually up to 1 year,
Purpose (goal)	Formulation of goals to be achieved and ways to achieve them	a) detailing the methods of resource support of the chosen ways to achieve goals; б) plan monitoring tool

Budgeting involves the construction of the so-called general budget, which is a system of interconnected operational and financial budgets:

General budget:

- Operating budgets
- Financial budgets

- Operating budget - a forecast of the revenues and expenses expected for one or more future periods.

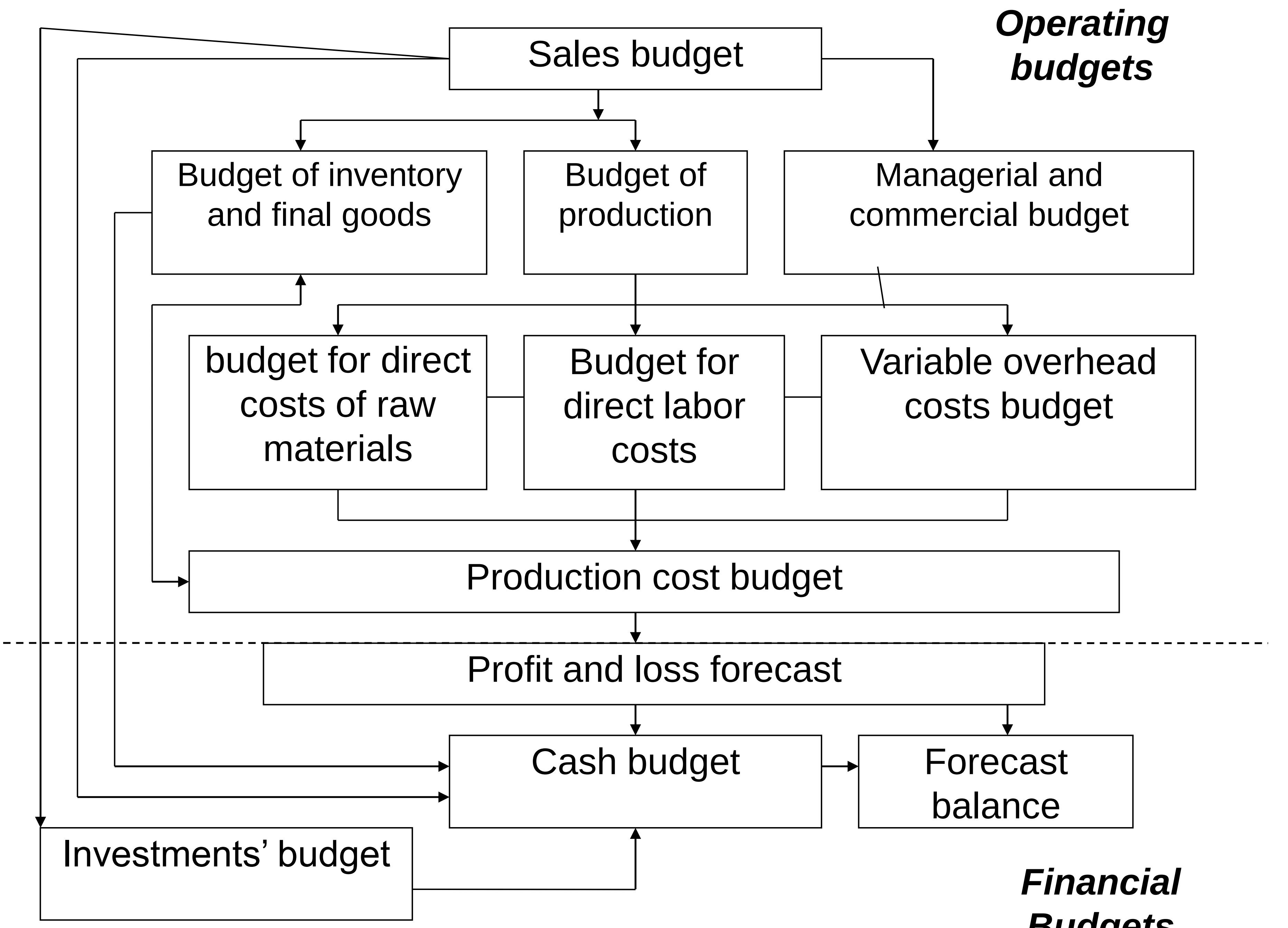
An operating budget is typically formulated by the management team just prior to the beginning of the year and shows expected activity levels for the entire year.

This budget may be supported by a number of subsidiary schedules that contain information at a more detailed level.

For example, there may be separate supporting budgets that address payroll, the cost of goods sold, and inventory. Actual results are then compared to the operating budget to determine the extent of any variances from expectations. Management may alter its actions during the year to bring actual results into line with the operating budget.

- Financial budget is predicting the income and expenses of the business on a long-term and short-term basis. Accurate cash flow projections help the business achieve its targets in the right way.

Financial budget preparation includes a detailed budget balance sheet, cash flow budget, the sources of income and expenses of the business, etc. The evaluation of incomes and expenses is done on a monthly, quarterly, half-yearly, or annual basis, depending on the organization’s suitability. It is a very powerful tool to achieve the long-term goals of any business. Importantly, it also keeps the shareholders and other members of the organization updated about the functioning of the business.


Operating budgets
Sales budget
Budget of inventory and final goods
Budget of production
Managerial and commercial budget
budget for direct costs of raw materials
Budget for direct labor costs
Variable overhead costs budget
Production cost budget
Profit and loss forecast
Cash budget
Forecast balance
Investments' budget
Financial Budgets

What is Financial Budget?

A financial budget is predicting the incomes and expenses of the business on long-term and short-term basis. Right projections of the cash flow help the business to achieve its targets in the right way.

Why is Financial Budget Prepared?

The organizations prepare the financial budget to manage the cash flows in a better way. This budget gives the business a better control and efficient planning mechanism to manage the inflows and outflows.

Different Sections of Financial Budget

- Cash Budget
- Budgeted Balance Sheet
- Capital Expenditure

Different Sections of a Financial Budget

Capital Expenditure Budget

As the name suggests, the capital expenditure budget relates to expenses related to plant and machinery or any capital asset of the business. This budget determines the expenses that would be incurred if an existing plant is replaced or any new machinery is bought. Factors like depreciation, cost of the plant, life of the machinery, etc., are taken into account when preparing the capital expenditure budget.

Budget Income Statement

The budgeted income statement contains comparative information of actual and budgeted data. Read more about the budgeted income statement.

Budgeted Balance Sheet

The budgeted balance sheet comprises many other budgets. The major component of this budget includes the production budget and its associated budgets.

3. Methods of financial planning

Method	Definition
1. *Normative method*	Company’s need for production and financial resources and their sources is calculated using established technical and economic standards. Norms may be established at the enterprise and production and financial indicators are planned on the base of them.
2. *Calculation and analytical method*	Based on the analysis of the achieved value of productional or financial indicators taken as the basis, and their changes in the planning period, the planned value of this indicator is calculated.
3. *Balance method*	The balance relation formula is– $S_b + R = P + S_e$, where S_b и S_e – Sources sum at the beginning and the end of planning period; П – receivables; P – payments.

Methods of financial planning (continued)

Method	Definition
4. *Method for optimizing planning decisions*	The method consists in developing few versions for plan calculations in order to provide the optimal choice.
5. *Economic and mathematical modeling*	Search for quantitative expressions of the relationship between productional and financial indicators and the factors that determine them. This relationship is expressed through an economic and mathematical model, which means an exact mathematical description of the economic process.

4. Organizing of budgeting of the enterprise

Organizing side	Content side
1. performers, periodicity, deadlines, etc.	Algorithms, initial data, economic meanings and assessments

Goal	Describe the future state of the enterprise in economic terms, which would ensure optimal achievement of the goals of the enterprise
Task	To develop the budget of the enterprise, providing optimal results for a given volume of economic activity
Result	Agreed and approved enterprise budget

Forecasting – the form of planning

Planning is performed when the managers possess the reliable estimates of indicators

Forecasting means probability estimates

Standard Budgeting Algorithm - Sales Planning

Conceptual scheme of transition to budgeting

Stages of transition	Description
1. Formation (clarification) of the organizational structure (OS) of the enterprise	Verification of OS and formation of financial goals for different levels of management
2. The formation of the financial structure (FS) of the enterprise	Identification or introduction of financial responsibility centers (FRC)
3. Budget structure constructing	The list of budgets, indicators, methods of their planning and forecasting
4. Combining financial and budgetary structures	Establishment of personal responsibility for the implementation of budget indicators
5. Description of the budget process	The procedure for the development, review, approval, execution of the budget and control and reporting.
6. Budgeting results	Analysis and managerial decisions

Stages	Projection	Organizational changes
1. OS	Functioning of OS levels Mission – strategic programs – financial goals of the enterprise	Clarification of OS Formation of the mission, strategic programs and financial goals
2. FS	Financial responsibility of OS. The executors of FRC in FS	Financial responsibility centers, their leaders, salaries, and budget indicators’ achievement motivation
3. BS	Enterprise’ activities – providing for budget sections – budgets – sections - executors	The budget system (BS), budget indicators, methods of planning and forecasting
4. FS&BS	BS for FS The executors of FRC in BS	Distribution of budgets between the FRC. Responsible for budgets or their sections

Stages	Projection	Organizational changes
5. Budget process	System of performance indicators. System of methods for planning and forecasting indicators	Forecasting and planning. Quantification of budgets
6. Results	Methods of analysis and verification	Budget execution analysis Adjusting an enterprise strategy or tactic Budget adjustment
7. Accounting for managers	Accounting chart on financial budgeting system (becomes a management chart of accounts)	Setting up a management accounting system at the enterprise

5. Constructing the financial structure of the enterprise

When developing budgeting systems, an often-applied approach is based on the construction of a financial structure, i.e. on the allocation of centers of financial responsibility as objects of budgeting and management accounting.

The organizational structure reflects the distribution of responsibility for the production and management functions, so as **financial structure —** forming income and payments**.**

Financial responsibility center— a structural unit (group of units) that performs certain business operations, directly affects the income / expenses of these operations and is responsible for the implementation of the goals set for it, compliance with expenditure levels within the established limits and the achievement of a certain financial result of its activities.

As a rule, four types of financial responsibility centers are distinguished in the financial structure:

1) Cost center;

2) Revenue center;

3) Profit center;

4) Investment center.

The head of the financial responsibility center of the first type controls costs, the second - income (revenue), the third - profit (costs and revenue) and the fourth - funds invested in the structural unit (costs, revenue and investments).

Sometimes the Financial Accounting Centers (cannot affect costs) and Margin Revenue Centers are formed.

Cost centers

It is necessary to take into account the technological and organizational characteristics of the company while forming cost centers. The locations of cost centers in enterprises are different and depend on the specific targets set by directors to managers.

The cost center can be both large enough (plant) and small (workplace). Large cost centers can consist of smaller ones, while several jobs can be combined into a larger cost center (department, service, workshop). The larger the center of financial responsibility, the higher the level of responsibility.

The head of such a FRC (department head, master) is directly responsible for the costs of this unit and must ensure that the planned indicators are met. The manager of the cost center must properly organize the rationing, planning and accounting of production costs. This is necessary for timely monitoring and cost management, evaluating the effectiveness of their use.

Cost centers

When forming the cost centers of an industrial enterprise, the following should be considered:

- each cost center, headed by the respective leader, is a separate area of responsibility;
- the cost center should combine approximately the same type of machine and jobs, causing costs of the same nature;
- all costs of the same type must be given to cost centers.

!!!Cost reduction has its limit, after which it is impossible without reducing product quality!!!

Revenue centers

Every FRC has some costs. However, in some cases, the management of the organization may decide to assign responsibility to the head (for example, the marketing department or the commercial department) only for income (revenue).

Dividing the enterprise into revenue centers, the administration considers this indicator to be the main one for assessing the performance of managers of structural divisions.

The income center is a structural unit of an enterprise whose head in the allocated budget is responsible for maximizing sales revenue, does not have the power to vary prices, and is limited in spending money (within the budget).

Revenue centers

When choosing income as the main evaluation criterion, the following rules should be considered:

- the income of each FRC should be formed objectively, regardless of the income of the whole enterprise;
- revenue growth of one unit should not reduce the income of the organization as a whole.

The criterion for evaluating the activities of managers is the amount of earned income.

Profit centers

The centers of profit at an industrial enterprise, as a rule, are production units that are formed as separate business units (which simultaneously control output and sales), for example, self-supporting structural units allocated to a separate balance sheet, or as subsidiaries.

The heads of profit centers:

- control both the income and expenses of their units;
- interested in increasing profit, because it is the indicator that evaluate the effectiveness of their work;
- have extended authority and responsibility than cost center managers.

The main goal of the profit center is to maximize profits based on the optimization of three factors: required resources, output and price.

Investment centers

Investment centers are business segments whose managers simultaneously control the revenues, expenses of their units, as well as the effectiveness of the funds invested in them. An example of such investment centers is large subsidiaries of industrial holdings. The main goal of the investment center is to maximize the market value (capitalization) of the subsidiary.

The managers of investment centers are entrusted not only with control of costs, incomes and profits, but also with the right to make investment decisions independently. They can divide investment resources allocated by the enterprise management to various projects based on a preliminary assessment of their commercial effectiveness.

Investment centers

To measure the performance of investment centers, various indicators are used, for example, transfer prices, the rate of return on investment (profit / investment). When measuring the rate of return on investment, most organizations include fixed assets in total investments at residual value, i.e. at cost less accumulated depreciation. This practice can “automatically” increase the rate of return on investments annually, since the denominator of the fraction is becoming smaller due to the annual increase in accumulated depreciation.

This approach of calculating the rate of return on investment does not motivate managers of investment centers to develop projects for technical re-equipment and modernization of production, since in the case of the adoption of a new investment project, this approach usually reduces the rate of return on investment.

Forming the FRC and FS

FRC may be formed:

- From one department
- By combining multiple units
- By dividing several parts in one unit, each of which becomes a FRC or joins to FRC

The financial structure is the organization of the FRC, constructing their subordination, authority and responsibility, and intended to manage the enterprise.

FS levels:

- Investment center
- Profit centers
- Margin revenue centers (if exist)
- Revenue and cost centers
- Revenue and cost centers of the 2nd level, etc.

The principles of the formation of FRC in a commercial organization:

- functional;
- territorial;
- organizational structure convenience;
- cost structure similarities.

The FRC would be successful if:

- consistency of goals and objectives of the organization as a whole and its FRCs;
- regulation of authority and financial responsibility for the head of the FRC;
- division of indicators of costs and revenues into regulated (controlled) and unregulated (uncontrolled);
- the manager’s sphere of responsibility includes only the indicators of costs and revenues that he can really influence on;
- monitoring the quality of work of the head of the FRC;
- creation of efficient material motivation system in the FRC.

6. Main features of budgeting

The budget of a small enterprise can be compiled by the head with the involvement of 1-2 employees.

The budget of the organization, medium in scale, is developed by a group of heads of departments (responsibility centers) and coordinated by the head of the financial service or chief accountant.

Large companies create a budget committee - a collegial body consisting of the heads of the organization and representatives of all budget centers. As a rule, no more than 10 such centers are created.

In budgeting committee, the collegiality is of great importance.

At the top are the head of the enterprise and financial director.

The main functions of the budget committee are:

- · The conversion of strategic budgets into operational - the definition of production capabilities of the organization, its competitive advantages, at the moment and the prospects for creating new types of products and services;
- · Organization of workshops to discuss the functioning of the budgeting system, the development of forms of planning and reporting documents, the creation of a personal responsibility system for the development and implementation of plans, the creation of a structure of budget responsibility centers, the revision of the budget regulations, etc.;
- · Approval of functional budgets and their consolidation in the general budget;

The main functions of the budget committee are:

- · Consideration of reports on the implementation of budgets and analysis of significant deviations;
- · Redistribution of funds between budget items, development of measures to eliminate the budget deficit, punishment and encouragement of responsible persons;
- · Resolution of conflicts in the functioning of the budget system - the distribution of personal responsibility of managers for joint projects, the impossibility of determining the results of activities of certain units, the reality and feasibility of standards, the presence of multidirectional goals of the organization (increase production and reduce costs).

Main recommendations for efficient budgeting

It is important to define and differentiate the powers and responsibilities of individual structural units. The interests of units should not overlap, and powers should not be duplicated.

An important function of the budget committee is to prioritize payments.

All decisions of the budget committee are binding. The exception is for the head of the enterprise and financial director only.

How the FRCs are communicating:

- transfer prices;
- taxation;
- internal loans;
- joint investment;
- conflict resolution (arbitration).

Personal financial planning

Personal financial planning is a process of managing money to achieve personal economic satisfaction. It is often confused with Investment planning however financial planning is not just about investment but covers much larger space of managing your money.

The most important tool of personal financial planning is the financial plan. In general usage, a personal financial plan can be a budget, a plan for spending and saving future income. This plan allocates future income to various types of expenses, such as rent or utilities, and also reserves some income for short-term and long-term savings. A financial plan can also be an investment plan, which allocates savings to various assets or projects expected to produce future income, such as a new source of income, business or product line, shares in an existing business, or real estate.

Personal financial planning process involves following steps :

Step 1: Determine your current financial situation.
your personal financial situation can be assessed by compiling simplified versions of financial balance sheets and income statements. A personal balance sheet lists the values of personal assets (e.g., car, house, clothes, stocks, bank account), along with personal liabilities (e.g., credit card debt, bank loan, mortgage). A personal income statement lists personal income and expenses.

Step 2: Develop your financial goals.
Two examples are "retire at age 55 with a personal net worth of Rm 1,000,000" and "buy a house in 3 years paying a monthly housing loan installment (mortgage servicing cost) that is no more than 35% of my gross income". It is not uncommon to have several goals, some short term and some long term. Setting financial goals helps direct financial planning.

Step 3: Identify alternative courses of action.
Once your short term and long-term goals are set, evaluate the gap between your current as well as desired situations. The financial plan details how to accomplish your goals.

Step 4: Evaluate your alternatives.
It could include, for example, reducing unnecessary expenses, increasing one's employment income, or investing in the stock market, mutual funds or regular savings plans.

Step 5: Create and implement your financial action plan.
Execution of your personal financial plan often requires discipline and perseverance. Many people obtain assistance from professionals such as accountants, financial planners, investment advisers, and lawyers.

Step 6: Review and revise your plan.
As time passes, your personal financial plan must be monitored for possible adjustments or reassessments. This is a cyclical processes.

Advantages of personal financial planning:

1) Increased effectiveness in obtaining, using, and protecting your financial resources.

2) Increased control of your financial affairs.

3) Improved personal relationships.

4) A sense of freedom from financial worries obtained by looking to the future.