CHAPTER 8: MANAGE FINANCIAL OPERATIONS/ MANAGING FINANCIAL OPERATIONS

8.1. Introduction of the Unit of Learning / Unit of Competency

Management of financial operations is the overseeing of financial activities in an organization. The trainee should be able to prepare an organization finance plan and budget according to standards of operation soft strategic plan organizational financial policy and organization budget manual. Establish corporate governance structure in accordance to financial reporting and audit standards, labor laws, human resource policy and risk management policy monitor and manage working capital and prepare an annual report as per procurement producer's financial statement and audit guidelines.

This unit will assist the trainee to be familiar with the financial aspects driving the economy. Business templates, financial templates, candidates authorized reports and assessment centers among many more will be used to guide the trainee on the standards which are set by the relevant governing bodies such as International Financial Accounting Standards (IFRS) and International Accounting Standards (IASs) in preparing the financial reports, budgets and annual organization performance reports. The trainee at the end of the training should be able to prepare budgets, financial statements, organization financial plan and also prepare the corporate governance structure this is in line with the provisions by the corporate business world.

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8.2. Performance Standard

Prepare an organization financial plan and budgets, financial statements and monitor, implement and analyze variances, manage working capital & the annual performance report in accordance with the SOP, strategic plan, and organizational finance plan, International Financial Accounting Standards (IFRS), International Accounting Standards (IASs) and policy guidelines of a specific country.

8.3. Learning Outcomes

8.3.1. List of Learning Outcomes

a) Prepare an organization financial plan
b) Prepare organization budget
c) Establish corporate governance structures
d) Monitor implementation of budgets and analyze variance
e) Manage working capital
f) Prepare financial statements
g) Analyze financial statement
h) Prepare annual performance report

8.3.2.Learning Outcome No. 1. Prepare Organization Financial Plan

8.3.2.1. Learning Activities

Learning Outcome #No. 1. Prepare Organization Financial Plan	
Learning Activities	Special Instructions
• Visit two organization's near your learning institution and study their environment, vision and objectives, prepare a postal and make an oral presentation. • Trainee to compute organization's revenues, sales and purchases from a given list of costs of an organization.	• Trainer to guide trainees in critiquing organization environment, vision and objectives. • The trainee poster should be kept or remain displayed as portfolio • Relevant and related documents to be availed

8.3.2.2. Information Sheet No. 8/LO1

Introduction

A financial plan entails the process of managing the current financial position of the business while forecasting on the future expectations. Financial planning is essential for the success of any business and it provides task of determining how a business will afford to achieve its strategic goals and objectives. Usually, a company creates a Financial Plan immediately after the vision and objectives have been set. The Financial Plan describes each of the activities, resources, equipment and materials that are needed to achieve these objectives, as well as the timeframes involved. In this lesson, we shall learn about the financial planning process that businesses perform, including preparation of a master budget, capital budget and cash budget.

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Definitions of key terms

Organizational data: This refers to any data that would be referenced to in relation to the organization which includes; sales/ revenue, purchases, production, labor, expenditure, vision, mission and objectives, internal structures, their processes and the behavior of the corporate actors in different social and economic context. (*Liebig, 2009)*

Financial plan: This refers to the projection of business financial performance by looking at the statement of financial position, income statement and statement of cash flow so as to be able to improve the general performance of the organization.

Financial planning is the task of determining how a business will afford to achieve its strategic goals and objectives. Usually, a company creates a Financial Plan immediately after the vision and objectives have been set. The Financial Plan describes each of the activities, resources, equipment and materials that are needed to achieve these objectives, as well as the timeframes involved.

The Financial Planning activity involves the following tasks:

a) Assess the business environment.
b) Confirm the business vision and objectives.
c) Identify the types of resources needed to achieve these objectives.
d) Quantify the amount of resource (labor, equipment, materials).
e) Calculate the total cost of each type of resource.
f) Summarize the costs to create a budget.

g) Identify any risks and issues with the budget set.

Performing Financial Planning is critical to the success of any organization. It provides the Business Plan with rigor, by confirming that the objectives set are achievable from a financial point of view. It also helps the CEO to set financial targets for the organization, and reward staff for meeting objectives within the budget set.

The role of financial planning includes three categories:

a) Strategic role of financial management
b) Objectives of financial management
c) The planning cycle

When drafting a financial plan, the company should establish the planning horizon, which is the time period of the plan, whether it be on a short-term (usually 12 months) or long-term (2–5 years) basis. Also, the individual projects and investment proposals of each operational unit within the company should be totaled and treated as one large project. This process is called aggregation.

Follow the case study below:

Case Study on Financial Planning Process

Meet Melissa. She's a financial manager for her company. One of her most important roles in the company is helping with the company's financial planning. Financial planning is a part of the overall business planning process; it's a piece of the puzzle that all businesses must figure out in order to achieve their objectives. **Financial planning** is the process of allocating financial resources to maximize the profitability and wealth of the company.

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Three Essential Questions

Melissa starts the planning process by asking three essential questions. First, what is the company's current state of affairs? You can consider this the starting point where Melissa analyzes the current situation of the company. For example, let's say that the company's leading product, a smartphone, has lost significant market share from a new smartphone on the market from a competitor.

Second, where does Melissa's company want to go? This is the ending point or the goal. For example, the president of Melissa's company wants a new smartphone developed so that it not only takes back the lost market share but also to improve upon its market share to increase the company's profit.

Third, how does the company get to its ending point or goal? Here is where financial planning kicks in because financial planning helps provide the course to take the company from where it is to where it wants to be from a financial standpoint.

Cash and Profit Planning

Melissa needs to pay attention to two important aspects of financial planning for a business. First, she needs to ensure that her company has sufficient liquidity and cash flow to operate. **Liquidity** is the ability to convert assets into cash quickly, and **cash flow** is simply the flow of cash into and out of the company.

Second, Melissa must consider profit planning in her overall analysis. For example, if the resources to be allocated to the new smartphone development can't produce a return, or profit, then the resources should be allocated elsewhere. Remember, the overall objective of a business is to earn a profit for its owners, and financial planning is a means to allocate resources to achieve that objective.

Other Factors to Consider

Melissa needs to factor in different variables when developing a successful financial plan. Each of these considerations may involve their own detailed analysis, but we'll paint with a broad brush and just give an overview.

Melissa helps her company determine whether getting from where it is to where it wants to be is feasible. **Financial feasibility** is an analysis whereby you determine if a particular venture is financially viable by taking into account the total costs of it and the probable revenues generated from it. For example, if it will cost more to make the new smartphone than the company can sell it for, then the project is not financially feasible.

Melissa also needs to determine the method of financing. Will the project be funded with the company's retained earnings, an offering of stock or bonds to investors, a loan from a bank or a combination of all these sources? If a combination will be utilized, what will the percentage mix of each type of financing be?

Just because a project is financially feasible doesn't necessarily mean it should be pursued. Melissa needs to consider the financial return compared to financial risk. In our example, do the anticipated profits justify the investment in the new smartphone? What will the company lose if the smartphone flops? How much will the company lose if it does flop? Are there alternative investments with a better risk/reward assessment?

Of course, a core purpose of planning is **resource allocation**, which is determining where the company's resources go. The financial plan will show how all the company's resources are allocated either on a project basis, a divisional basis, a product basis or some other organizational method. For example, Melissa's company may show resources allocated by project, such as the new smartphone project. Looking at the allocation of resources will give you a clue about a company's priorities and strategy.

Every good plan should include financial controls during implementation. **Financial control** is a system developed to allow the business to control and monitor the acquisition, allocation and utilization of the financial resources to ensure they are done in accordance with the plan. Of course, there may be regulatory reasons for financial controls as well.

- Financial Targets
- Growth in revenues – the changes of revenue for at least two financial years
- Growth in earnings- changes in earnings from one year to another.
- Wider profit margins- ability to continue giving dividends to shareholders that are incremental
- Higher returns on invested capital- ability to choose the portfolios with higher risks
- Diversified revenue base- investment in variety of investment

Organizational need assessment- Is determining an organization’s needs which involves the initiation, data collection and analysis and production, and hence identify the gaps that are preventing it from reaching its desired goals

Methods of needs assessment

- Gap analysis/ discrepancy analysis- Comparison of preference with stated intended competences
- Objective knowledge – the purpose of the organization existence governed by the vision, mission and objectives
- Skill tests – what skill does the organization have and which are they going to outsource
- Observation- scout around and see what is it that you can do
- Revalidation – reassessment of exactly what is in the real situation

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- Self-assessment- to what extent can the organization be able to achieve their objectives
- Peer review- People in the same industry/ section assessing different works

Finance Committee

Its sole purpose is to provide financial oversight for the organization which have responsibility of budgeting and financial planning, financial reporting and creation and monitoring of internal controls and accountability.

Conclusion

Organization plan is the bigger picture of an organization purpose of existence and it must be interned with the vision, mission and the objectives. This gives the direction of the organization which determines its success and it continuity. Clear instructions, clear job description, direct channels of communication makes things easier and hence increased morale to the staff and commitment to the organization.

8.3.2.3. Self-Assessment

1. Financial feasibility is a system that allows business to control and monitor acquisition.
   True [ ]   False [ ]
2. Define the following terms
   - Financial feasibility
   - Financial control
   - Business environment
3. What are the main consideration for preparing organization financial plan
4. Discuss the various importance of financial planning in an organization
5. From given data select the appropriate ones to determine revenues, sales
6. Describe the procedures followed for development of an organization financial plan

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8.3.2.4. Tools, Equipment, Supplies and Materials

- Computers
- Calculators
- Format templates
- Internet
- Samples of Organization data

8.3.2.5. References (APA)

2. Stefan Liebig, (2009), Organizational Data, Working Paper Series of the German Council for Social and Economic Data 67

8.3.3. Learning Outcome No. 2. Prepare Organization Budgets

8.3.3.1. Learning Activities

Learning Outcome #No. 2. Prepare Organization Budgets	
Learning Activities	Special Instructions
From the provided samples of financial information data of an organization, prepare the following organization budgets • Sales budget • Income budget • Production budget • Cash budget • Budgeted balance sheet	• Provide samples of organization financial information data or guide trainee is identify such from the internet

8.3.3.2. Information Sheet No. 8/LO2

Introduction

Budgets are the yardsticks for good financial performance of every business. Therefore they need to be carefully drafted. Budgets may be functional or operational and master budgets. In this lesson, we shall learn about the budgeting process and demonstrate the different budgets in the financial sector including preparation of a master budget, capital budget and cash budget.

Definitions of key terms

- **Functional Manager:** These are personnel who are entrusted with the management of different organization departments e.g. Marketing, Production, Procurement, Chief Finance Officer, Human Resource and Research and Development Managers.

- **Functional Budgets:** These are budgets prepared by the functional managers in each organizational department such as sales budget, production budget, purchases budget, cash budget, expenditure budget and production cost budget.

- **Master Budget:** It is a budget that contains the forecasted income statements and the forecasted statements of financial position of a given financial year.

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A functional budget

This is one which relates to any of the functions of an undertaking. They are subsidiary to the master budget which is the summary budget incorporating its component functional budgets which is finally approved, adopted and implemented. These include: sales budget, production budget, plant utilization budget, capital expenditure budget, selling and distribution budget, purchasing budget and cash budget.

The Master budget

On completion of the sub diary budgets, the budget officer will prepare a master budget. It will contain total budgeted sales and costs which are detailed in the subsidiary budgets. It shows the total picture of the projected results of the business for the next period. The budget committee will consider the master budget and if they approve it, it will be submitted to the

board of directors for final approval. Amendments may be requested at this stage and alterations may be necessary. When it is finally approved, it represents a standard which should be achieved by each department in the organization. When the budget is submitted to the board for approval it is usual practice to supply suitable notes to explain why any major differences from previous periods have occurred.

Preparation of budgets

Preparation of budgets is done by use of data from production for units produced, production costs/ unit, cash budget for cash received and cash paid where the willing method is employed

Case Study

On 31st December, 2017 a Company Y had1400 units of product Z10 in the stores and in the year 2018 sold 2000 units and in the year 2018, 1800 units were in store. Prepare the production Budget

Sol:

Product Z10

Production Budget 2018

	Units
Closing Stock	1800
Add Sales	2000
	3800
Less of Stock	1400
Production Units	2400

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Cash Budget

- Credit terms for the purchases (credit) will be set for payments
- Credit terms for the sales (credit) will be set for collections.

Example 2: .Royal Company is preparing budgets for quarter ending June 30.

Budgeted sales for the next five months are:

April	20,000units
May	50,000units
June	30,000units
July	25,000units
August	15,000units.

The selling price is $10 perunit.

	April	May	June	Quarter
Budgeted sales in units	20,000	50,000	30,000	100,000
Selling price per unit	$ 10	$ 10	$ 10	$ 10
Total budgeted sales	$ 200,000	$ 500,000	$ 300,000	$ 1,000,000

Expected Cash Collections

- All sales are on account.
- Royal's collection pattern is:
  70% collected in the month of sale,
  25% collected in the month following sale, 5% uncollectible.
- The 31st March accounts receivable balance of$30,000 will be collected in full.

	April	May	June	Quarter
Accounts receivable 3/31	$ 30,000			$ 30,000
April Sales				
70% x $200,000	140,000			140,000
25% x $200,000		50,000		50,000
May Sales				
70% x $500,000		350,000		350,000
25% x $500,000			125,000	125,000

From the Sales Budget for May.

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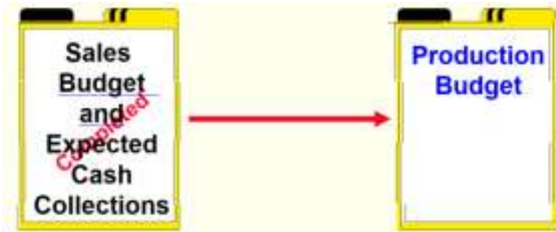
Total Cash Collection $170,000$400,000

The Production Budget



Production must be adequate to meet budgeted sales and provide for sufficient ending inventory

The Production Budget

Example: The management at Royal Company wants ending inventory to be equal to 20% of the following month's budgeted sales in units.

•On March 31st 4,000 units were on hand.

Let's prepare the production budget.

The Production Budget

	April	May	June	Quarter
Budgeted Sales	20,000	50,000	30,000	100,000
Add: Desired ending inventory	10,000	6,000	5,000	5,000
Total Needs	30,000	56,000	35,000	105,000
Less: Beginning inventory	4,000	10,000	6,000	4,000
Required production	26,000	46,000	29,000	101,000

Assumed ending inventory.

The Cash Budget

Royal:

- Maintains a 16% open line of credit for $75,000
- Maintains a minimum cash balance of $30,000
- Borrows on the first day of the month and repays loans on the last day of the quarter.
- Pays a cash dividend of $49,000 in April
- Purchases $143,700 of equipment in May and $48,300 in June (both purchases paid in cash)

As at April 1st cash balance of $40,000 was recorded

Prepare a cash budget.

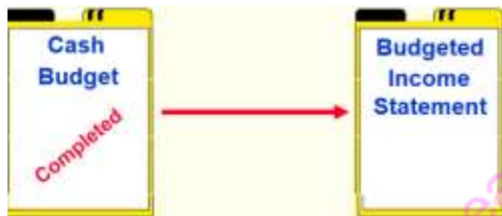
THE CASH BUDGET

	April	May	June	Quarter
Beginning cash balance	$ 40,000	$ 30,000	$ 30,000	$ 40,000
Add: Cash collections	170,000	400,000	335,000	905,000
Total cash available	210,000	430,000	365,000	945,000
Less: Cash disbursements				
		72,300	72,700	185,000
		23,000	15,000	53,000
		76,000	59,000	191,000
		85,000	75,000	230,000
		143,700	48,300	192,000
Dividend	49,000	-	-	49,000
Total disbursements	230,000	400,000	270,000	900,000
Excess (deficiency)	(20,000)	30,000	95,000	45,000
Financing:				
Borrowing	50,000	-		50,000
Repayments	-	-	(50,000)	(50,000)
Interest	-	-	(2,000)	(2,000)
Total financing	50,000	-	(52,000)	(2,000)
Ending cash balance	$ 30,000	$ 30,000	$ 43,000	$ 43,000

$50,000 × 16% × 3/12 = $2,000

Borrowings on April 1 and repayment on June 30.

The Budgeted Income Statement



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After we complete the cash budget, we can prepare the budgeted income statement for Royal.

BUDGETED INCOME STATEMENT

Royal Company
Budgeted Income Statement
For the Three Months Ended June 30

Sales (100,000 units @ $10)	$ 1,000,000
Cost of goods sold (100,000 @ $4.99)	499,000
Gross margin	501,000
Selling and administrative expenses	260,000
Operating income	241,000
Interest expense	2,000
Net income	$ 239,000

Sales Budget.

Ending Finished Goods Inventory.

Selling and Administrative Expense Budget.

Cash Budget.

BUDGETED BALANCE SHEET

Royal reported the following account balances prior to preparing its budgeted Financial statements:

- Land - $50,000
- Common stock - $200,000
- Retained earnings - $146,150
- Equipment - $175,000

Royal Company
Budgeted Balance Sheet
June 30

Current assets		
Cash	$	43,000
Accounts receivable		75,000
Raw materials inventory		4,600
Finished goods inventory		24,950
Total current assets		147,550
Property and equipment		
Land		50,000
Equipment		367,000
Total property and equipment		417,000
Total assets	$	564,550
Accounts payable	$	28,400
Common stock		200,000
Retained earnings		336,150
Total liabilities and equities	$	564,550

25% of June sales of $300,000.

11,500 lbs. at $0.40/lb.

5,000 units at $4.99 each.

50% of June purchases of $56,800.

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Conclusion

In preparation of budgets accurate ascertainment of the items to be used for each budget must be put into consideration otherwise wrong budgets prepared would lead to wrong decisions being made. A budget put in place should be reviewed in accordance to the vision and position of the entity in question. Over estimation or under estimation of a budget will lead to wrong forecasting of expected position.

8.3.3.3. Self-Assessment

a) What is the name of the budget prepared on the completion of sub diary budgets
   - Master budget
   - Functional Budget

b) Explain the various types of budgets that a business entity can prepare/

c) Differentiate between budget estimate and actual budget

d) What is the importance of budgeting in business

e) Prepare a budget by extracting the items that differentiate an actual budgets with the budgeted estimates

8.3.3.4. Tools, Equipment, Supplies and Materials

- Computers
- Calculators
- Printers
- Format templates

8.3.3.5. References

1. Owler, L. W. J & Brown, J. L, (1980), Wheldons Costing Simplifies (6th Ed.), McDonalds& Evans Ltd, British Library
2. Sagwa Phillip, (2018), Financial Management, (1sted)Manifested Publishers Ltd, Kenya
3. Saleemi N.A. (2010), Cost Accounting Simplified ,(Revised and Updated ,ed), Saleemi Publications, Nairobi , Kenya

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8.3.4. Learning Outcome No. 3. Establish Corporate Governance Structures

8.3.4.1. Learning Activities

Learning Outcome #No. 3. Establish Corporate Governance Structures	
Learning Activities	Special Instructions
• Make a visit to two organizations in your town and observe their governance structures. • Assume you are a manager in charge of a transport service in your organization.	• Critic the two structures observed. • Prepare a corporate structure suitable for your organization.

8.3.4.2. Information Sheet No. 08/LO3

Introduction

Business organizations must put their houses proper for effective management and to enhance the achievement of their objectives as it gives them the direction where each of them would be going. This is elaborated by a clear corporate structure. This call for everybody involved in the organization to be aware of his/ her responsibility. The channels of communication must be clear resolution of conflicts model.

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Definition of key terms

Corporate governance

As defined by Gabrielle O'Donovan, corporate governance is an internal system encompassing policies, processes and people, which serve the needs of shareholders and other stakeholders, by directing and controlling management activities, with good business objectivity, accountability and integrity.

Content

A corporate strategy is a clearly defined long-term vision that organizations set, seeking to create corporate value and motivate the work force to implement the proper actions to achieve customer satisfaction.

It is a continuous process that requires a constant effort to engage investors in trusting the company with their money, thereby increasing the company's equity. Financial reporting is conducted using the principles of Accounting and also the International Financial Reporting Standards (IFRS).

Auditing will be conducted using the International Auditing Standards that are acceptable.

For proper financial operation activities, there has to be qualified personnel to ensure the rewards maintained are accurate and correct, free from posting errors.

The corporate structure must be in-place and well communicated to everyone.

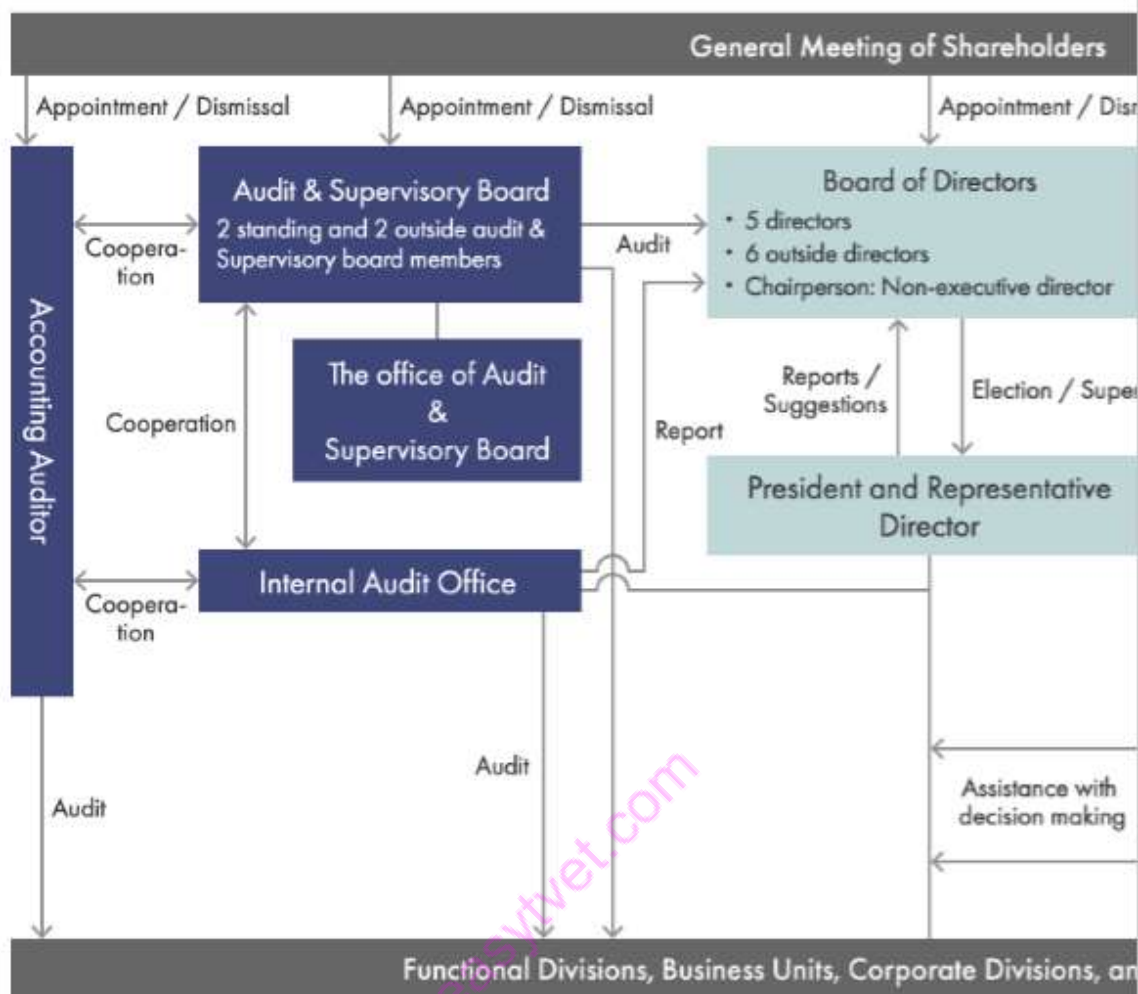

Figure 26: Corporate Governance Structure

Corporate structure refers to the organization of different departments or business units within a company. Depending on a company's goals and the industry which it operates in, corporate structure can differ significantly between companies. Each of the departments usually performs a specialized function while constantly collaborating with each other to achieve the corporate goals,Mission and Values. CFI's mission is to help anyone become a world-class financial analyst. Learn more about Corporate Finance Institute's mission, vision, values and culture.

Departments in a company include Human Resource, IT, Accounting and Finance, Marketing, Research and Development (R&D), and Production Cost of Goods Manufactured (COGM) Cost of Goods Manufactured (COGM) is a schedule showing the total production costs during a specific period of time. See COGM formula & examples in this guide. COGM is the total costs incurred to manufacture products and transfer them into finished goods inventory for actual retail sale. Some product-based or project-based companies may divide up business units by addressing a single product or project as a department.

Types of Organizational Structure

There are four general types of organizational structure that are widely used by businesses all around the world:

1. Functional Structure

Under this structure, employees are grouped into the same departments based on similarity in their skill sets, tasks, and accountabilities. This allows effective communications between people within a department and thus leads to an efficient decision-making process. Companies with departments such as IT and Accounting. Our Accounting guides and resources are designed as self-study guides to learn accounting and finance at your own pace. Browse hundreds of articles on important topics such as the income statement, balance sheet, cash flow statement, depreciation methods, how to link the 3 statements, debits & credits, journal entries are good examples of a functional structure.

2. Divisional Structure

This structure organizes business activities into specific market, product, service, or customer groups. The purpose of the divisional structure is to create work teams that can produce similar products matching the needs of individual groups. A common example of the divisional structure is geographical structure, where regional divisions are built to provide products or service to specific locations.

3. Matrix Structure

Matrix Structure is a combination of functional and divisional structures. This structure allows decentralized decision making, greater autonomy, more inter-departmental interactions, and thus greater productivity and innovation. Despite all the advantages, this structure incurs higher costs and may lead to conflicts between the vertical functions and horizontal product lines.

4. Hybrid Structure

Like the Matrix Structure, the Hybrid Structure combines both functional and divisional structure. Instead of grid organization, Hybrid Structure divides its activities into departments that can be either functional or divisional. This structure allows utilization of resources and knowledge in each function, while maintaining product specialization in different divisions. Hybrid Structure is widely adopted by many large organizations.

Learning about a Company's Corporate Structure

When an FP&A analyst FP&A Analyst Become an FP&A Analyst at a corporation. We outline the salary, skills, personality, and training you need for FP&A jobs and a successful finance career. FP&A analysts, managers, and directors are responsible for providing executives with the analysis and information they need performs various analyses and modeling. What is Financial Modeling? Financial modeling is performed in Excel to forecast a company's financial performance. Overview of what is financial modeling, how & why to build a model. A 3-statement model links income statement, balance sheet, and cash flow statement. More advanced types of financial models are built for valuation, planning, and corporate structure is often one of the first things taken into consideration, because how the departments are defined directly influences the construction of any model.

1. Corporate structure is the basis for building any financial models

Depending on the kind of products/services a company provides or the industry it is in, its corporate structure can look very different from other businesses. Therefore, it is essential for the FP& A analyst to work closely with different business units in the company to understand their responsibilities and areas of expertise.

The FP&A analyst should organize regular meetings and communicate consistently with the different business units to keep up with the latest trends in the market, new and existing projects, short-term and long-term work plans, and expected opportunities in the project pipeline. That way, not only can the analyst familiarize himself with the ongoing activities in each team, he is also able to respond quickly to changes in budgets and forecasts with the latest information.

2. Businesses with functional or divisional structures tend to use straightforward modeling

Out of the four organizational structures, functional and divisional structures are the easiest to build financial and forecasting models on, because of the simplicity of the companies' departmental structure. An FP&A analyst can easily gather data, perform analysis and realize variances, identify data trends, and forecast future performance for each department.

Sometimes, an FP&A analyst may drill down to as deep as each employee when collecting information for detailed analysis. Because all employees are in a single reporting relationship in a functional or divisional structure, the analyst can easily track individual performance, working hours, and expenditures. This helps in performing precise analysis on departmental costs, earnings, and productivity, without simply making a lot of assumptions.

3. Matrix structure companies may incur more estimations on various factors

In a matrix structure, employees have dual reporting relationships, generally to both a functional manager and a division/product manager. It can lead to conflicts in resource utilization between a division and a function, making it more difficult to implement cost allocation because a single employee can be a member of two teams at the same time.

Moreover, it is more challenging for an FP&A analyst to develop a perfect forecasting model for matrix structure companies because there are many resources overlapping and ambiguous reporting lines. Measuring employee productivity rates and project expenses may require some estimations on individual working hours spent on various products or projects.

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Conclusion

Organization structure gives the bigger picture of an organization purpose of existence and it must be interned with the vision, mission and the objectives. This gives the direction of the organization which determines its success and its continuity. Clear instructions, clear job description, direct channels of communication makes things easier and hence increased morale to the staff and commitment for the organization.

8.3.4.3. Self-Assessment

1. Which of the following governance structure allows decentralization of decision making greater autonomy and more departmental interactions
    - o Matrix
    - o Divisional
    - o Hybrid
2. Working closely with various company units in a business helps in producing an effective corporate governance structure. Indicate whether it is true

    True [ ]   False [ ]
3. Define and give characteristics of the following governance structure
    - Matrix
    - Hybrid
    - Functional
4. Discuss why it is important for organizations to have a governance structure/

5. Given corporate structures from two local companies critique the corporate structures of two identified organizations.
6. Prepare a corporate structure of the organization where you are the manager.

8.3.4.4. Tools, Equipment, Supplies and Materials for the specific learning outcome

- Computer
- Calculator
- Organization Policy Manual
- Auditing Standards Manual
- Internal Financial Reporting Standards Manual

8.3.4.5. References (APA)

1. Dube C. F, (2008), Corporate Governance, Non-Executive Directors' Independence.

8.3.5. Learning Outcome No. 4. Monitor Implementation of Budgets and Analyze Variance

8.3.5.1. Learning Activities

Learning Outcome #No. 4. Monitor Implementation of Budgets and Analyze Variance	
Learning Activities	Special Instructions
• From two types of budgets identify the variances from the statements	• Compute the variances and interpret them

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8.3.5.2. Information Sheet No. 8/LO4

Introduction

Monitoring of the budget entails having an oversight of the performance of the performance of the budget put in place in an organization. By the end of the training the trainee should be able to review the actual and budgeted financial results determine and analyze variances and choose the appropriate correction action.

Definitions of key terms

Actual Financial Results – These are the results of the prevailing financial year that have been achieved

Budgeted Financial Results- This is the standard that was set and approved by the management that was to guide the supervisors in the respective functional departments

Variance- It's the difference that can be seen when comparing the budgeted values and the prevailing values and prices like of goods in the market.

E.g. In operating profit variances, material usage, material price variance, raw material price, wage rate variance, labor efficiency variances, overhead expenditure variances etc.

Content

The budgeted results are the standards that are set by the management in order to give the direction and the targets, for which performance of the respective functional managers will be assessed in case of major difference between the actual results and the budgeted. It should be explained and this is what is referred to as variances from comparing items from the statement

Standard
It's a norm or bench mark. It is useful for comparison and may be used indicate minimum quality. E.g. Standard of passing.

Standard Cost
An estimated or pre-determined cost of performing an operation or producing a good or service, under normal conditions. It is used as a basis for cost control through variance analysis.

It is chosen to serve as a benchmark in the standard costing/ budgetary control system. It is a budget for the production of one unit of product or service.
It is a pre-determined cost which is calculated from management's standards of efficient operation and the relevant necessary expenditure.

Standard Costing
It is a cost accounting technique for cost control where standard costs are determined and compared with actual costs, to initiate corrective action. It is a control method involving the preparation of detailed cost and sales budgets. A management tool used to facilitate management by exception.

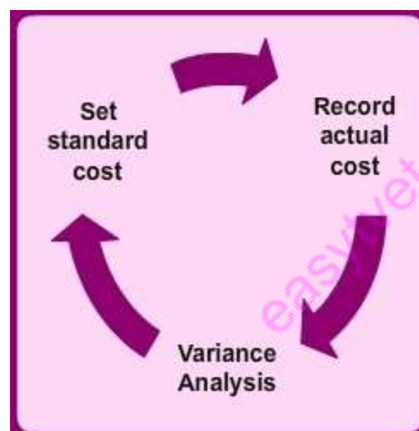

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Figure 27: Steps in Standard Costing

Steps in Standard Costing

Set the standard cost
A standard quantity is predetermined and standard price per unit is estimated. Budgeted cost is calculated by using standard cost.

Record the actual cost
Calculate actual quantity and cost incurred giving full details.

Variance Analysis
This entails comparison of the actual cost with the budgeted cost so as to maintain control of the business as a whole. The cost variance is used in controlling cost.

Types of standards Ideal Standards:
These represents the level of performance attainable when prices for material and labour are most favorable, when the highest output is achieved with the best equipment and layout and when maximum efficiency in utilization of resources results in maximum output with minimum cost.

Normal Standards:
These are the standards that may be achieved under normal operating conditions. The normal activity has been defined as number of standard hours which will produce normal efficiency sufficient goods to meet the average sales demand over a term of years.

Basic or Bogey standards:
These standards are used only when they are likely to remain constant or unaltered over long period. According to this standard, a base year is chosen for comparison purposes in the same way as statistician use price indices.
When basic standards are in use, variances are not calculated as the difference between standard and actual cost. Instead, the actual cost is expressed as a percentage of basic cost.

Current Standard:
These standards reflect the management's anticipation of what actual cost will be for the current period. These are the costs which the business will incur if the anticipated prices are paid for goods and services and the usage corresponds to that believed to be necessary to produce the planned output.

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Variance
The difference between standard cost and actual cost of the actual output is defined as Variance. A variance may be favorable or unfavorable. If the actual cost is less than the standard cost, the variance is favorable and if the actual cost is more than the standard cost, the variance will be unfavorable. It is not enough to know the figures of these variances in fact it is required to trace their origin and causes of occurrence for taking necessary remedial steps to reduce / eliminate them.

Variance - Types

The purpose of standard costing reports is to investigate the reasons for significant variances so as to identify the problems and take corrective action. Variances are broadly of two types, namely, controllable and uncontrollable.

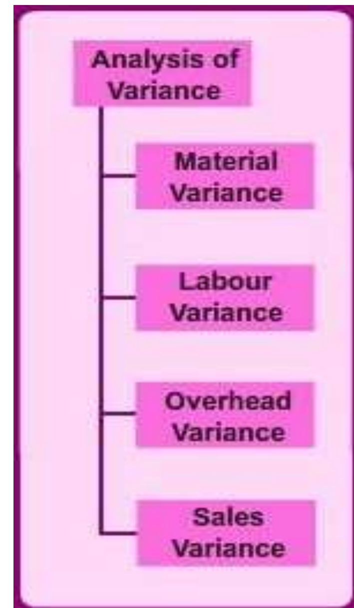

Figure 28: Variance Analysis Chart

Controllable Variance

Controllable variances are those which can be controlled by the departmental heads whereas uncontrollable variances are those which are beyond their control. If uncontrollable variances are of significant nature and are persistent, the standards may need revision.

Variance Analysis

Variance analysis is the dividing of the cost variance into its components to know their causes, so that one can approach for corrective measures.

Variances of Efficiency:

Variance arising due to the effectiveness in use of material quantities and labor hours. Here actual quantities are compared with predetermined standards.

Variances of Price Rates:

Variances arising due to change in unit material prices, standard labor hour rates and standard allowances for indirect costs. Here actual prices are compared with pre-determined ones.

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Variances of Due to Volume: Variance due to effect of difference between actual activity and the level of activity estimated when the standard was set.

Reasons for Material Variance

- Change in Basic price.
- Failure to purchase anticipated standard quantities at appropriate price.
- Use of sub-standard material.
- Ineffective use of materials. Pilferage.

Material Variance

Material Cost Variance = (Standard Quantity X Standard Price) – (Actual Qty X Act Price)

Material Price Variance = Actual Quantity (Standard Price - Actual Price)

Material Usage Variance = Standard Price (Standard Quantity - Actual Quantity)

Reasons of Labor Variance Time Related Issues.

- Change in design and quality standard. Low Motivation.

- Poor working conditions.
- Improper scheduling/placement of labor. Inadequate Training

Rate Related Issues. Increments / high labor wages. Overtime.
Labor shortage leading to higher rates. Union agreement.
Labor Variance
Labor Cost Variance = (Standard Hrs X Standard Rate Per Hour) –(Actual Hrs X Actual Rate Per Hour)
Labor Rate Variance = Actual Hrs (Standard Rate - Actual Rate)
Labor efficiency Variance = Standard Rate (StdHrs - Actual Hrs worked)
Idle Time Variance = Idle Hours X Std Rate

Reasons for Overheads Variance

- Under or over absorption of fixed overheads. Fall in demand/ improper planning.
- Breakdowns /Power Failure. Labor issues.
- Inflation.
- Lack of planning. Lack of cost control.

Variable Overheads (OH) Variance
Variable OH Cost Variance = (Standard Hrs X Standard Variable OH Rate) – Actual OH Cost

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Variable OH Variance
Variable OH Expenditure Variance = (Actual Hrs X Standard Variable OH Rate) – Actual OH Cost
Variable OH Efficiency Variance = (Standard Hrs - Actual Hrs) X Standard Variable OH Rate

Fixed Overheads (OH) Variance
Fixed OH Cost Variance = Absorbed OH – Actual OH Absorbed OH = Actual Units * Standard OH Rate per unit

Fixed OH Variance
Fixed OH Expenditure Variance = Budgeted OH – Actual OH Fixed OH Volume Variance = Absorbed OH – Budgeted OH

Reasons of Sales Variance

- Change in price. Change in Market size.
- Change in Market share.

Sales Variances
Sales Value Variance = Budgeted Sales – Actual Sales
Sales Price Variance = Actual Quantity (Actual Price - Budgeted Price)
Sales Volume Variance = Budgeted Price (Actual Quantity - Budgeted Quantity)

Advantages of Standard Costing Advantages

- Basis for sensible cost comparisons.
- Employment of management by exception. Means of performance evaluation for employees. Result in more stable product cost.

Disadvantages of Standard Costing

- Too comprehensive hence time-consuming. Precise estimation of prices or rates is difficult.
- Requires continuous revision with frequent changes in technology/ market trends. Focus on cost minimization rather than quality or innovation.

Material Variance
Material Cost Variance Material Price Variance Material Usage Variance
Can we sub-divide Usage Variance?
What are its causes, when we have more than one Raw Material?

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Material Variance
Material Cost Variance Material Price Variance Material Usage Variance Material Yield Variance Material Mix Variance
Material Cost Variance = (Standard Quantity X Standard Price) – (Actual Qty X Act Price)
Material Price Variance = Actual Quantity (Standard Price - Actual Price)
Material Usage Variance = Standard Price (Standard Quantity - Actual Quantity) Material Yield Variance (Std Input Qty - Actual Input Qty) * Std Price of Std Input Material Mix Variance = Standard Price (Revised Standard Quantity - Actual Quantity)

Fixed Overheads (OH) Variance
Fixed OH Cost Variance = Absorbed OH – Actual OH Absorbed OH = Actual Units * Standard OH Rate per unit

Fixed OH Variance
Fixed OH Expenditure Variance = Budgeted OH – Actual OH Fixed OH Volume Variance = Absorbed OH – Budgeted OH

Material Variance
F OH Cost Variance
F OH Expenditure Variance F OH Volume Variance
Can we sub-divide Volume Variance?
What are its causes, why may volume vary?

Fixed OH Variance

Fixed OH Efficiency Variance = Standard OH Rate per hour (Standard Hrs - Actual Hrs)

Fixed OH Capacity Variance = Standard OH Rate per hour (Budgeted Hrs - Actual Hrs

Conclusion

Once budgets have been approved they are to be implemented. After implementation then monitoring is carried out by different personnel from the organization who is to determine whether there has been any difference between the budgeted amounts and the actual figures. This is to ensure there are no overstatements of figures even with the assumption of the officers being people of high integrity.

8.3.5.3. Self-Assessment

1. There are types of variance type which one is used to control overhead costs?
    - Controlled variance
    - Non controlled variance
2. The following are reasons for overhead variance which one is not
    - Under absorption of fixed overhead
    - Breakdown /power failure
    - Ineffective use of materials
    - Inflation
3. Define the following terms as used in business
    - Standard Cost
    - Variance
    - Variance analysis
4. What are some of the reasons for sales variance?
5. Discuss the importance of calculate variance?
6. Using a budget for a middle level organization identify variances
7. Calculate the various variances in the budget.

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8.3.5.4. Tools, Equipment, Supplies and Materials

1. Computers
2. Calculator
3. Actual & Budgeted results

8.3.5.5. References

1. Saleemi, S. M, (2010), Cost Accountancy Simplified, (Revised and Updateded),SaleemiPublicationsLtd, Nairobi, Kenya.
2. Owler, L. W. J & Brown, J. L, (1980), Wheldons Costing Simplifies (6th Ed.), McDonalds& Evans Ltd, British Library

8.3.6. Learning Outcome No. 5. Manage Working Capital

8.3.6.1. Learning Activities

Learning Outcome #No. 5. Manage Working Capital	
Learning Activities	Special Instructions
• Visit an organization next to your institution or in your institution • In the same organization compute the current ratio, quick ratio, stock turnover • Calculate the bad debts from the Accounts Receivables. • From the cash book and the bank statements of organization Z.	• Carry out inventory counting. • Use the specified formulas to calculate the ratios and the bad debts • Construct a bank reconciliation statement

8.3.6.2 Information Sheet No. 8/LO5

Introduction

Managing working capital is the process of overseeing the relationship between a firm's short term assets and its short term liabilities. Proper management of working capital components such as inventory, cash, trade payables and trade receivables is vital for optimum financial performance of any entity. This lesson is going to direct the trainee on the proper working capital techniques in line with the mentioned components.

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Definitions of key terms

Working Capital- It's the capital of a business which is used in its day to day trading operations. It represents operating liquidity available to a business, organization or other entity. It is also known as the operating assets or net current assets.

Inventory- according to working capital inventory is defined as items of sales which take the longest time to be converted to cash or cash equivalents.

Accounts receivables- these are the amounts payable to the organization from customers who have been purchasing goods on credit terms.

Accounts payables-these to an organization are current liabilities which arise from the suppliers providing goods or services to the organization on credit terms.

Prepayments -these are payments made in advance to the organization or the suppliers for work that has not yet been done. They are assets if it's the organization that has paid them in advance and liabilities when it's the organization which has received payment in advance.

Accrual-these are obligations which arise due to delayed payment by the organization but the service has already been offered.

Content

Working capital being the measure of a company's liquidity, efficiency and overall health, it involves cash, inventory, accounts receivable, accounts payable, the portion of debt due within one year and other short term accounts. It will involve the inventory management, debt management, revenue collection and payment to suppliers.

Working Capital= Current Assets – Current Liabilities

With positive working capital indicates that a company is able to pay off its short term liabilities almost immediately.
In a decreasing working capital indicates that the company is over-leveraged and it’s struggling to maintain or grow sales, is paying bills too quickly or is collecting receivables too slowly

To evaluate working capital, the following methods are adopted;
- Inventory turnover
- The receivables ratio
- Days payable
- Current ratio
- Quick acid ratio

$$\text{Working Capital Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Working Capital Ratio = (Cash + Short-term investments + Inventory + A/C Receivable) / (Short-term notes +
A/C Payable)

The healthy working capital ratio will be between *1:0* and *2:0*

Inventory management is important consideration in working capital management.
- The longer inventory sits on the shelf or in the warehouse, the longer the company’s working capital is tied up. When not managed carefully, business can grow themselves out of cash by needing more working capital to fulfill expansion plans than they can generate in their current state.
- This arises when the company has used cash to pay for everything rather than seeking financing that would smooth out the payment and make cash available for other uses. As a result, working capital shortages causes many businesses to fail even though they have been making a profit.

The debtor’s collection period must be carefully fixed
The level and timing of a company’s cash flows are what really determine whether a company is able to pay its liabilities when due.

WORKING CAPITAL
The capital of a business which is used in its day-by-day trading operations, calculated as the current assets minus the current liabilities. Working capital is also called operating assets or net current assets.

WORKING CAPITAL MANAGEMENT
Working capital management refers to a company’s managerial accounting strategy designed to monitor and utilize the two components of working capital, current assets and current liabilities, to ensure the most financially efficient operation of the company.

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FACTORS AFFECTING WORKING CAPITAL

a. Nature of business
b. Production policy
c. Credit policy
d. Inventory policy
e. Abnormal factor
f. Market conditions
g. Conditions of supply
h. Business cycle
i. Taxation policy
j. Dividend policy
k. Operating efficiency
l. Price level changes
m. Depreciation policy
n. Availability of raw material

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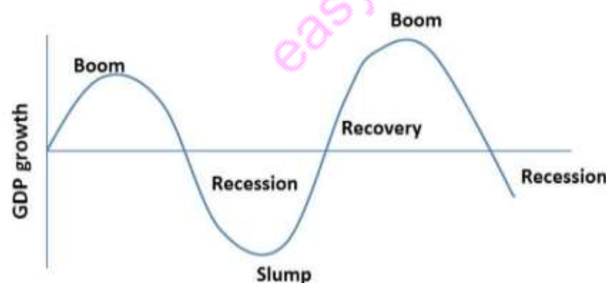
BUSINESS CYCLE



HOW MUCH WC IS NEEDED?

It depends on the following factors-

- Size of the firm
- Activities of the firm
- Availability of credits
- Attitudes towards profit
- Attitude toward risks
- Others

IMPORTANCE OF ADEQUATE WC/ OPTIMUM WC

a. Smooth running of business
b. Profitability with manage risk
c. Growth and development possibility
d. Smooth payment
e. Increase in goodwill
f. Improve trade relationship

g. Others

SOME IMPORTANT ISSUES

A. Monetary level of cash receivable & inventory
B. To have understanding of percentage of fund in current account
C. Recording time spent in managing current account

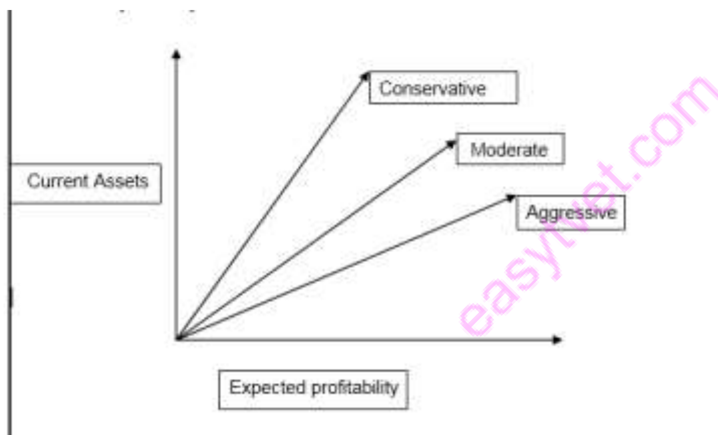
WORKING CAPITAL POLICY / APPROACHES

It can be explained by two approaches:

- Conservative approach
- Aggressive approach

Conservative approach: A firm financing its common permanent assets & also with long term financing & less risky so far as insolvency is concerned. However funds may be invested in such investment which fetches small returns to build up liquidity.

Aggressive approach: The firm uses only short term financing. In this approach, the firm finances a part of the permanent assets with short term financing. This approach refers to more risky but may return to the assets.



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FINANCING OF WORKING CAPITAL

Financing of working capital can be done in two ways:

- Long term sources
- Short term sources

A. **Long term sources**

1. Share capital
   - Equity share capital
   - Preference share capital
2. Debentures
   - Convertible debentures
   - Non-convertible debentures
   - Redeemable debentures
   - Non-Redeemable debentures
3. Bonds
4. Loans from banks & financial institutions
5. Retained earnings

6. Venture capital fund for innovative projects

B. **Short term sources**

1. Bank credit
2. Transaction credit
3 Advances from customers
4. Bank advances
5. Loans
6. Overdraft
7. Bills purchase and discounted
8. Advance against documents of title of goods
9. Term loans by bank
10. Commercial paper
11. Bank deposits

Conclusion

Working capital management refers to a company's managerial accounting strategy designed to monitor and utilize the two components of working capital; current assets and current liabilities, to ensure the most financially efficient operation of the company. Proper working capital management enhances the continuity of an organization, in its operations into the foreseeable future due to its ability to meet its financial obligations when they fall.

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8.3.6.3. Self-Assessment

1. Working capital measures companies ____________________
    - Health, profits , efficiency
    - Health liquidity and efficiency
    - Efficiency, employee satisfactions and sustainability
    - Which of the following consideration
2. The following are consideration for how much working capital one will require for their business which one is not
    i. Risks
    ii. Size of the firm
    iii. Credits
    iv. Company Policy
3. Discuss the various factors affecting a business working capital
4. Why is it important for businesses to have adequate working capital
5. Define the following terminologies
    a) Working capital
    b) Accounts receivables
    c) Accrual
    d) Prepayments
6. Undertake inventory counting.
    a) Compute working capital ratios.
    b) Construct a bank reconciliation statement

8.3.6.4. Tools, Equipment, Supplies and Materials

1. Computer
2. Calculator
3. Formulas of calculating stock levels

4. Procurement and Disposal Act

8.3.6.5. References

1. Gill, A., Biger, N., & Mathur, N. (2010). The relationship between working capital management and profitability: Evidence from the United States. Business and Economics Journal, 4 (2), 1

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8.3.7. Learning Outcome No. 6. Prepare Financial Statements

8.3.7.1. Learning Activities

Learning Outcome #No. 6. Prepare Financial Statements	
Learning Activities	Special Instructions
f) Guided by the IFRS Select the appropriate source documents among a range of them of a given organization.	• Prepare the financial statement of the organization according to International Financial reporting Standard and GAAPS (Generally Accepted Accounting Principles

8.3.7.2. Information Sheet No. 8/LO6

Introduction

Financial statements can basically be defined as accounting data prepared at the end of a financial year derived from the day to day activities of the business. The information used in financial statements is derived from fact and applications of judgment.

The process of crafting together various elements of information will inevitably involve applying a large number of accounting concepts. If its process was not strictly regulated by a conceptual framework, we would end up with financial reports that are subjective or even misleading.

By the end of the lesson the trainee should be able to prepare the required financial statements which are generally accepted for a public limited company. These but a few include income statement, statement of financial position and statement of cash flow.

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Definitions of key terms

Financial information- it is the data such as credit cards number, credit ratings, account balances and other monetary facts about a person or organization that are used for billing, credit assessment, loan transactions and other financial activities.

Financial information must be processed in order for a business to be conducted but it must also be carefully handled to ensure security for customers and to avoid the liquidation and bad publicity that can stem from negligence or improper uses.

Income statement-also called a profit and loss statement is a report made by company accountant that shows the revenue, expenses, and net income or loss for a period.

Statement of financial position- originally called the balance sheet is a financial statement that reports the assets, liabilities, and equity of a company on a specific date. It's usually prepared at the end of every financial year which mostly is one year.

Statement of cash flow-this is a summary of the actual an anticipated incomings and outgoings of cash in an entity in an accounting period usually one year.

Content

In preparation of financial statements the general purpose will include the balance sheet, income statement and statement of retained earnings and statement of cash flows which represents the purpose of financial accounting.

Process

It involves aggregating accounting information into a standardized set of financials. The completed financial statements are then distributed to lenders, creditors and investors who use them to evaluate the performance liquidity and cash flows of a business.

a) Compare the receiving log to accounts payable to ensure all supplier invoices have been received
b) Compare the shipping log to the account receivable to ensure that all custom invoices have been issued.
c) Accrue an expense for any wages earned but not yet paid at the end of reporting panel
d) Calculate depreciation and Expense for all fixed account.
e) Conduct an ending physical inventory count or alternative method.
f) Conduct a bank reconciliation and create journal entries.
g) Post all subsiding ledge balances to the general ledger.
h) Review the balance sheet accounts and use journal entries to adjust the account balances.
i) Print preliminary version of the financial statement and review them for errors.
j) Accrue an income tax expense.
k) Close all subsidiary ledgers for the period
l) Print a final version of the financial statements
m) Compile foot notes to accompany the financial statements to explain key points.
n) Distribute the financial statements

Format for statement of financial position

Rose Amukuya

Financial position as at 1st July 2006

Fixed assets				
Land & building	XX			
Furniture and fittings	XX			
Motor van	XX			
				XX
Current Assets				
Stock	XX			
Debtors	XX			
Cash	XX			
Total Current assets	XX		XX	
Less **current liabilities**				
Creditors	XX			
Bank overdraft	XXXX			
Total current liabilities				
Working capital_XX				
XX				
Financed by				
Owners' Equity		XX		
Loan CDC	XX			
			XX	

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NB/ Assets and liabilities are arranged in the order of their liquidity.

Format for statement of cash flow

ABC CASH FLOW
FOR THE YEAR ENDED 31ST DEC 2006

Changes in cash (X- Y)	**XXX**	
Net income / profit		XX
Items not affecting cash		
(a) Depreciation		xx
Cash from operating activities		
(b) Decrease / increase in receivables	xx	Inflow and outflow
© Increase / decrease in prepaid Expenses	xx	
(d) Increase / decrease in accounts Payable	xx	
(e) Interest payable	xx	
(f) Increase / Dec. of wages & salaries	xx	
(g) Paying other expenses	xx	
(h) Paying government taxes	xx	
(i) Sales of goods and services	xx	
(j) Dividends received	xx	
(k) Profit from sale of fixed assets	xx	
	XX	
Investing activities		
Inflow		
-Sale of property and equipment	xx	
-Sale for debt equity and securities	xx	
-Collection of principal on loan	xx	
		XX
Outflow		
Purchase of property and equipment	xx	
Purchase debtors equity	xx	
Paying of loans	xx	
	XX	**XX**
Financing activities		
Inflow		
-Sale of own equity	xx	
-issuance of debts bonds	xx	**XX**
Outflow		
-Shareholders dividend	xx	
-Redeemed long term	xx	
		XX
Net change in cash		**XXX**

Conclusion

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Financial statements are prepared using the IFRS, IASs and the GAAPs which indicate the quality of financial information which in exchange enhances the type of decisions that will be made from them. A properly prepared financial statement will be essential in determining the position of the firm for easy decision making and further investment.

8.3.7.3. Self-Assessment

1. The following documents are needed in preparation of financial statement, which one is not?
    a) Company Charter
    b) Balance sheet
    c) Income statements
    d) Statement for cash flow
2. Define the following terms
    - Financial statements
    - Income statements
    - Cash flow
3. Outline the procedure you will follow in preparing financial statement for an organization?
4. Discus the various tools used in preparing financial statements
5. Visit the finance department of your institution with assistance from the finance officers select the appropriate source documents and prepare financial statements.
6. Select the appropriate source documents and prepare the financial statements

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8.3.7.4. Tools, Equipment, Supplies and Materials

- Computers
- Printers
- Calculator

8.3.7.5 References

1. Siagwa P., (2016), Financial accounting, (1st ed), Manifested publishers ltd, Nairobi , Kenya
2. Baston A, (1980), Elements of accounting, (4th ed), Great Britain Publishers
3. Wood F (2006) Principle of financial accounting for East Africa

8.3.8. Learning Outcome No. 7. Analyze Financial Statements

8.3.8.1. Learning Activities

Learning Outcome #No. 7. Analyze Financial Statements	
Learning Activities	Special Instructions
• Pick two period financial statements and prepare analysis.	• Using the standard formulas calculate the ratios to indicate the variances.

8.3.8.2. Information Sheet No. 8/LO7

Introduction

Once the financial statements have been prepared and distributed to management and interested stakeholders they must compare the figures appearing in the previous trading or accounting period.

Financial statement analysis (or financial analysis) is the process of reviewing and analyzing a company's financial statements to make better economic decisions to earn income in future. These statements include the income statement, balance sheet, statement of cash flows, notes to accounts and a statement of changes in equity (if applicable). Financial statement analysis is a method or process involving specific techniques for evaluating risks, performance, financial health, and future prospects of an organization.

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Definitions of key terms

Financial statements – these are formal records of the financial activities and position of a business a given reporting period.

Content

Financial statements are used by investors, market analysts and creditors in order to evaluate a company's financial health and earnings potential. It will include the balance sheet, income statement and statement of cash flows.

The financial statement is intended to provide information about the financial position performance and changes in financial position of an enterprise that uses a wide range of uses in making economic decisions.

(IASB) framework.

The uses of financial statements information are managers, stakeholders, prospective investors, financial institutions, suppliers, customers, employees, competitor's general public. The accounting ratios can be used to assess the trend of the business in its operations.

There are generally six steps to developing an effective analysis of financial statements.

1. Identify the industry economic characteristics.

First, determine a value chain analysis for the industry—the chain of activities involved in the creation, manufacture and distribution of the firm's products and/or services. Techniques such as Porter's Five Forces or analysis of economic attributes are typically used in this step.

2. Identify company strategies.
Next, look at the nature of the product/service being offered by the firm, including the uniqueness of product, level of profit margins, and creation of brand loyalty and control of costs. Additionally, factors such as supply chain integration, geographic diversification and industry diversification should be considered.

3. Assess the quality of the firm's financial statements.
Review the key financial statements within the context of the relevant accounting standards. In examining balance sheet accounts, issues such as recognition, valuation and classification are keys to proper evaluation. The main question should be whether this balance sheet is a complete representation of the firm's economic position. When evaluating the income statement, the main point is to properly assess the quality of earnings as a complete representation of the firm's economic performance. Evaluation of the statement of cash flows helps in understanding the impact of the firm's liquidity position from its operations, investments and financial activities over the period—in essence, where funds came from, where they went, and how the overall liquidity of the firm was affected.

4. Analyze current profitability and risk.
This is the step where financial professionals can really add value in the evaluation of the firm and its financial statements. The most common analysis tools are key financial statement ratios relating to liquidity, asset management, profitability and debt management/coverage, and risk/market valuation. With respect to profitability, there are two broad questions to be asked: how profitable are the operations of the firm relative to its assets—independent of how the firm finances those assets—and how profitable is the firm from the perspective of the equity shareholders. It is also important to learn how to disaggregate return measures into primary impact factors. Lastly, it is critical to analyze any financial statement ratios in a comparative manner, looking at the current ratios in relation to those from earlier periods or relative to other firms or industry averages.

5. Prepare forecasted financial statements.
Although often challenging, financial professionals must make reasonable assumptions about the future of the firm (and its industry) and determine how these assumptions will impact both the cash flows and the funding. This often takes the form of pro-forma financial statements, based on techniques such as the percent of sales approach.

6. Value the firm.
While there are many valuation approaches, the most common is a type of discounted cash flow methodology. These cash flows could be in the form of projected dividends, or more detailed techniques such as free cash flows to either the equity holders or on enterprise basis. Other approaches may include using relative valuation or accounting-based measures such as economic value added.

The next steps;
Once the analysis of the firm and its financial statements are completed, there are further questions that must be answered. One of the most critical is: "Can we really trust the numbers that are being provided?" There are many reported instances of accounting irregularities. Whether it is called aggressive accounting, earnings management, or outright fraudulent financial reporting, it is important for the financial professional to understand how these types of manipulations are perpetrated and more importantly, how to detect them.

Tools of Financial analysis

Financial ratios are very powerful tools to perform some quick analysis of financial statements. There are four main categories of ratios: liquidity ratios, profitability ratios, activity ratios and leverage ratios. These are typically analyzed over time and across competitors in an industry.

Liquidity ratios are used to determine how quickly a company can turn its assets into cash if it experiences financial difficulties or bankruptcy. It essentially is a measure of a company's ability to remain in business. A few common liquidity ratios are the current ratio and the liquidity index. The current ratio is current assets/current liabilities and measures how much liquidity is available to pay for liabilities. The liquidity index shows how quickly a company can turn assets into cash and is calculated by: (Trade receivables x Days to liquidate) + (Inventory x Days to liquidate)/Trade Receivables + Inventory.

Profitability ratios are ratios that demonstrate how profitable a company is. A few popular profitability ratios are the breakeven point and gross profit ratio. The breakeven point calculates how much cash a company must generate to break even with their startup costs. The gross profit ratio is equal to gross profit/revenue. This ratio shows a quick snapshot of expected revenue.

Activity ratios are meant to show how well management is managing the company's resources. Two common activity ratios are accounts payable turnover and accounts receivable turnover. These ratios demonstrate how long it takes for a company to pay off its accounts payable and how long it takes for a company to receive payments, respectively.

Leverage ratios depict how much a company relies upon its debt to fund operations. A very common leverage ratio used for financial statement analysis is the debt-to-equity ratio. This ratio shows the extent to which management is willing to use debt in order to fund operations. This ratio is calculated as: (Long-term debt + Short-term debt + Leases)/ Equity

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Conclusion

Once financial statements have been prepared and signed, then they require to be analyzed to establish whether the objectives have been achieved or not. Also to determine the current trend and then compare with the previous reporting period financial statements and ascertain the changes. Analysis is done for comparison with other businesses in the same industry and also to compare performance of the same organization for the different accounting periods.

8.3.8.3.Self-Assessment

1. Which tool is used to determine how quickly a company can turn its assets into cash
    - Bank statements
    - Financial Ratios
    - Liquidity ratio
    - Depreciation price
2.
3. Discuss the procedures one would follow in preparation of analysis of financial statement?
4. Describe the various tools in financial analysis
5. You have been given two financial statements from different companies. Use them to
    - Calculate the profitability ratio
    - Calculate the liquidity ratio
    - Interpret the results

8.3.8.4. Tools, Equipment, Supplies and Materials for the specific learning outcome

g) Computers
h) Calculators
i) Financial statements for two financial periods
j) Printers

8.3.8.5. References

1. Wood , Frank and Sangster, (2012), Business Accounting vol 1 7thed
2. Siagwa P. (2016), Financial accounting, 1StedManifested publishers ltd, Nairobi , Kenya
3. Baston A(1980),Elements of accounting,4 th,edGreat Britain Publishers

8.3.9. Learning Outcome No. 8. Prepare Annual Performance Report

8.3.9.1. Learning Activities

Learning Outcome #No. 8. Prepare Annual Performance Report	
Learning Activities	Special Instructions
• Examine a given set of source documents from an organization for a reporting period. • From the same documents	• Identify the controls observed from the source documents. • Prepare a report on your findings.

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8.3.9.2. Information Sheet No. 08/LO8

Introduction

Performance reports are important to an organization as they provide the information to the management and other stake holders on whether the financial commitments that were budgeted have been achieved or not. This is only achieved after the financial statements have been examined by an external auditor who verifies that they present the true and fair view of the financial position of an organization by using the audit guideline as per International auditing standards.

Content

Performance report is detailed statement that measures the results of some activity in terms of its success over a specific time frame e.g., an annual performance report might be produced for each employee of a business or such a report might help management assess the success of a project or product and how well budgetary constraints were adhered to.
The reports should provide all the information needed by stakeholders to the level of detail required by them. It's an important activity in project communication management. It involves collecting and disseminating project information, communicating project progress, utilization of resources, and forecasting future progress and status to various stakeholders, as decided in the communication management plan.

An organizational strategy is the sum of the actions a company intends to take to achieve long-term goals. Together, these actions make up a company's strategic plan. Strategic plans take at least a year to complete, requiring involvement from all company levels.

Organization strategy is an expression of how an organization needs to evolve over time to meet its objectives along with a detailed assessment of what needs to be done. Developing an organization strategy for a business involves first comparing its present state to its targeted state to define different and then stating what is required to be desired changes to take place. Below a designs of strategies that can be adopted.

Figure 29: Organizational Structure

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Figure 30: Organizational Strategy

The development and implementation of a risk measurement performance and reporting framework. Establishes a comprehensive risk reporting system that is aligned with other organizational performance management structures and processes.
Risk performance and reporting

	Leadership level	Senior level	Management level	Support level
Risk reporting systems	Establishes a comprehensive risk reporting system that is aligned with other organizational performance management structures and processes.	Reports on the strategic and financial impact of risks.	Ensures that risk reporting systems operate efficiently.	Explains the purpose of measuring and reporting risk performance and the use of technology to support effective risk management.
Risk performance indicators	Defines organizational Key Risk / Performance Indicators (KRIs/KPIs) for evaluating risk management performance, strategy, processes and controls.	Specifies the design requirements of risk performance reporting systems.	Uses analytical tools and techniques to monitor changes to an organization's risks and opportunities and updates risk information.	Complies with legal, ethical and regulatory requirements in the gathering and recording of risk information.
Risk reporting protocols	Ensures that risk reporting systems enable effective decision making and are capable of identifying actual and emerging risks.	Reports recommendations for improvements based on systematic analyses of information at agreed intervals.	Produces risk management reports, highlighting areas of concern, change, emerging threats and opportunities.	Explains the uses of risk information and reports the potential consequences of poor risk reporting.

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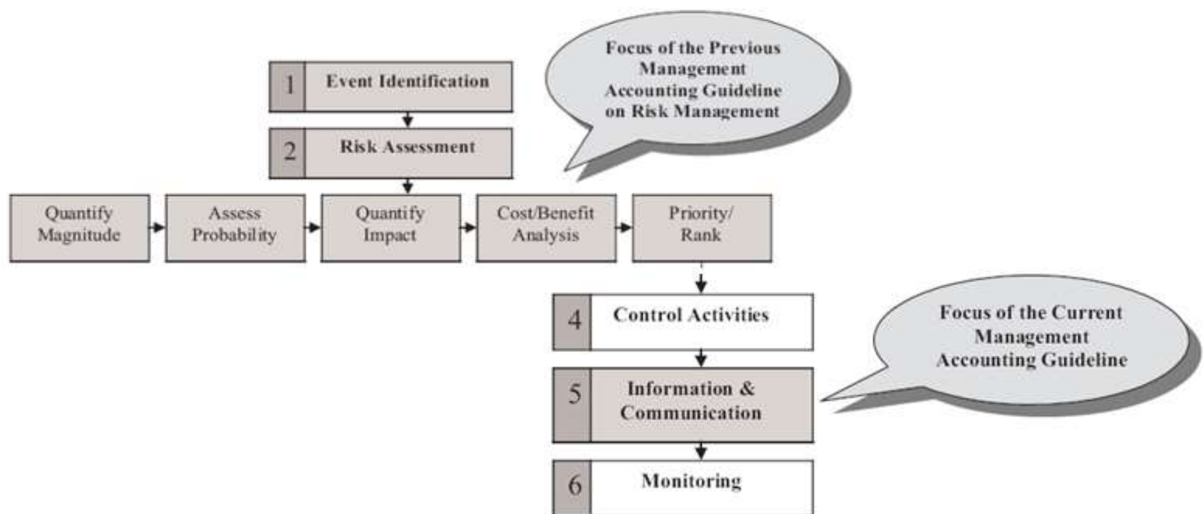

Figure 31: Risk Management Process

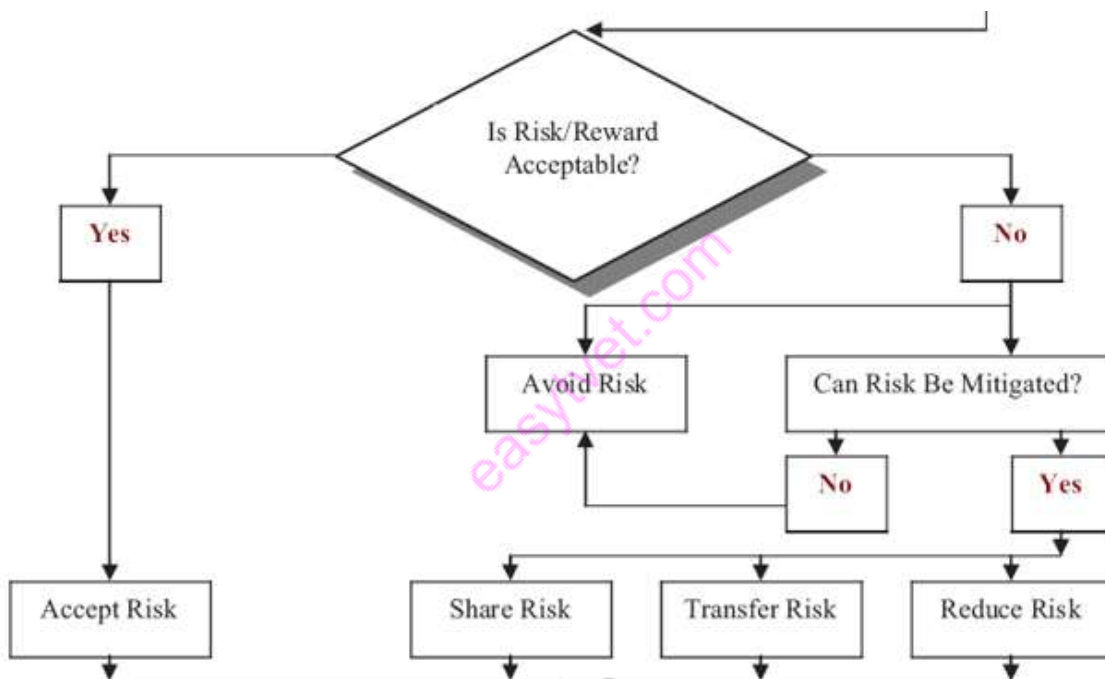

Figure 32: Risk Management

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Exhibit 2: Organizational Risks

Risks

Strategic Risks	Operations Risks	Reporting Risks	Compliance Risks
Economic risks Industry risks Strategic transaction risks Social risks Technological risks Political risks Organizational systems' risks	Environmental risks Financial risks Business continuity risks Innovation risks Commercial risks Project risks Human resource risks Health and safety risks Property risks Reputational risks	Information risks Reporting risks	Legal and regulatory risks Control risks Professional risks

Epstein and Rejc, 2005.

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Conclusion

Performance reports are prepared after all the analysis of the organization financial statements, organization strategies, risks contingencies and the non-financial activities have been analyzed and then the final report is prepared which will indicate any need for any changes. The report is based on the standard operation procedures of the organization, which will be measure of the extent of objectives achievement which will indicate the need or no of corrective action.

8.3.9.3. Self-Assessment

1. Annual financial performance report is used in communicating organization goals and vision?
   False [ ]   True [ ]
2. Annual performance report should capture its components from the organization strategy?
   True [ ]   False [ ]
3. Why is organizational strategy important for preparation of annual financial report?
4. Outline the various components in an annual performance report?
5. Identify the controls various source documents for annual document
6. Using existing documents in your organization prepare an annual performance report for your institution.

8.3.9.4. Tools, Equipment, Supplies and Materials for the specific learning outcome

- Computers
- Calculators
- Source documents

- Financial statements for two financial periods
- Printers
- Audit guidelines manual

8.3.9.5. References

1. Wood, Frank and Sangster, (2012), Business Accounting vol 1(7th ed)
2. Sagwa P., (2016), Financial accounting,(1st ed), Manifested publishers ltd, Nairobi , Kenya
3. Baston A, (1980),Elements of accounting, (4th ed), Great Britain Publishers

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