

Unit 13: **Managing Financial Principles and Techniques**

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| Unit code: | A/602/2334 |
| Level 7 | BTEC Professional |
| Credit value: | 15 |
| Guided learning hours: | 45 |

Unit aim

This unit provides the learner with the skills to apply financial principles relevant to strategic management in an organisational context, including forecasting, capital appraisal, budgeting, financial appraisal and analysis.

Unit introduction

Organisations operate in a very competitive and continually changing environment where effective decision making is crucial if an organisation is to survive or even be profitable. An important resource for decision making is financial information and it is important for managers to be able to interpret, analyse and evaluate this information effectively.

This unit will give learners a foundation in financial principles and techniques relevant to the strategic management process. It encourages learners to explore the nature of cost-based financial data and information, the impact of the budgeting process on the organisation, and the development of cost reduction and management procedures and processes. It also focuses on the management of these costs through the use of forecasting, appraisal and financial reporting procedures. One of the main objectives of this unit is for learners to develop the confidence to apply, analyse and evaluate financial and cost information.

Learners will develop the ability to judge the sources, nature, accuracy and completeness of cost-based information and influence others to make decisions that are based on well-researched options. These important decision-making skills will be enhanced further through the use and validation of forecasting techniques, the consideration of financial statements and making judgements on the validity of information sources used in the decision-making process.

Learners will also apply strategies associated with determining sound management information with reference to sources of funds, the potential investment of resources and the interpretation of financial statements.

Learners will study issues of cost, responsibility and control in the contexts of management accounting and the management process. This unit gives learners the opportunity to enhance their competency in the construction, review and evaluation of cost-based financial information, and introduces them to the analysis and control or reduction of costs in a range of situations.

Learning outcomes and assessment criteria

In order to pass this unit, the evidence that the learner presents for assessment needs to demonstrate that they can meet all the learning outcomes for the unit. The assessment criteria determine the standard required to achieve the unit.

On completion of this unit a learner should:

| Learning outcomes | Assessment criteria |
|---|---|
| 1 Be able to apply cost concepts to the decision-making process | 1.1 explain the importance of costs in the pricing strategy of an organisation 1.2 design a costing system for use within an organisation 1.3 propose improvements to the costing and pricing systems used by an organisation |
| 2 Be able to apply forecasting techniques to obtain information for decision making | 2.1 apply forecasting techniques to make cost and revenue decisions in an organisation 2.2 assess the sources of funds available to an organisation for a specific project |
| 3 Be able to participate in the budgetary process of an organisation | 3.1 select appropriate budgetary targets for an organisation 3.2 participate in the creation of a master budget for an organisation 3.3 compare actual expenditure and income to the master budget of an organisation 3.4 evaluate budgetary monitoring processes in an organisation |
| 4 Be able to recommend cost reduction and management processes for an organisation | 4.1 recommend processes that could manage cost reduction in an organisation 4.2 evaluate the potential for the use of activity-based costing |

| Learning outcomes | Assessment criteria |
|---|---|
| <p>5 Be able to use financial appraisal techniques to make strategic investment decisions for an organisation</p> | <p>5.1 apply financial appraisal methods to analyse competing investment projects in the public and private sector</p> <p>5.2 make a justified strategic investment decision for an organisation using relevant financial information</p> <p>5.3 report on the appropriateness of a strategic investment decision using information from a post-audit appraisal</p> |
| <p>6 Be able to interpret financial statements for planning and decision making</p> | <p>6.1 analyse financial statements to assess the financial viability of an organisation</p> <p>6.2 apply financial ratios to improve the quality of financial information in an organisation's financial statements</p> <p>6.3 make recommendations on the strategic portfolio of an organisation based on its financial information</p> |

Unit content

1 **Be able to apply cost concepts to the decision-making process**

Costs and prices: absorption and marginal costing – their nature, similarities, differences and use in pricing; relationship to pricing policy; influences on pricing strategy

Cost systems: classifications in terms of object; function, product/service and behaviour; opportunity cost, recording and analysing costs; job costing; batch costing; process costing; contract costing; standard costing; variance calculations; variance analysis and management by exception

Responsibility and control of systems: cost centre; profit centres; investment centres; accountable management; planning and control methods

2 **Be able to apply forecasting techniques to obtain information for decision making**

Forecasting techniques: forecasting costs; cash flow forecasts; scatter graphs; linear regression; time series methods; forecasting and price movement; using indices, limitations of index numbers; forecasting problems and limitations; place of qualitative data; recommendations

Funds: sources; supporting proposals for obtaining funds internally and externally; gearing ratios; effect of different types of funding on shareholder and market perception; selecting appropriate sources of funds for different projects – comparison of costs

3 **Be able to participate in the budgetary process of an organisation**

Target setting: comparison to previous years; links between targets; realism; organisational objectives

Process: importance to management; the steps in the process from subsidiary/functional to master budget; relationship to cost and quality control, resource utilisation and profitability; computer-assisted processes

Budgets: types; flexible and fixed budgets; zero-based budgeting

Monitoring process: budgeted and actual figures, accounting for and investigating variances; favourable and adverse variances; the need for prompt and relevant corrective action; behavioural issues relating to budgeting eg management participation authority, performance evaluation

4 Be able to recommend cost reduction and management processes for an organisation

Cost reduction: purpose compared with cost control (standard costing and budgetary control); value analysis and value engineering; difficulties with introducing cost reduction programmes; quality and value, Total Quality Management (TQM), measuring the costs of quality

Activity-based costing: development of activity-based costing (ABC); use in calculating costs and pricing policy; activity-based budgeting; merits and limitations of these systems

5 Be able to use financial appraisal techniques to make strategic investment decisions for an organisation

Investment: definition; capital and revenue expenditure; types and interaction with risk; sensitivity analysis

Investment appraisal: accounting rate of return; payback period and cash flows, discounted cash flow – net present value and internal rate of return, time value of money and allowance for inflation in money and real rates of discount, taxation and project appraisal; post-audit

6 Be able to interpret financial statements for planning and decision making

Statements: estimates and assumptions relating to the profit and loss account; balance sheet and cash flow statement; use of spreadsheets in financial planning; financial resource audits and the use of balanced scorecards – Kaplan and Norton

Financial ratios: employment of financial ratios internally and externally; financial profiles of organisations; calculation of key ratios reflecting business liquidity; efficiency and profitability

Interpretation and limitations of ratio analysis: emphasis on the interpretation of ratios and encouragement of the use of contingency and risk analysis to justify and make strategic portfolio decisions

Essential guidance for tutors

Delivery

When delivering this unit, tutors need to consider the problems that some learners may have in relation to numbers (no matter what their level in their own organisation). Most learners will not be accountants and, wherever possible, delivery needs to be in the context of how useful financial techniques are in strategic planning and decision making. Learners will need to have the opportunity to practise financial techniques in the classroom with tutor support available.

This unit enables learners to enhance and refine techniques commonly used to improve financial decision making as part of the strategic management process. It also allows them to explore and utilise techniques relating to financial decision making. Techniques must be appropriate for individual learners within the strategic management process. It is essential that learners are encouraged, wherever possible, to relate the focus of the unit to their own organisation and share their experiences in class discussions and presentations.

Research will be necessary on aspects of the unit content, but application must be current and relevant and learners could use work-related experiences and projects. In certain circumstances, respecting the necessary degree of confidentiality, learners may be able to compare and contrast competing organisations operating within different economic sectors. Additionally, the use of case studies and current examples of issues within the public domain could enhance the learning process.

For learning outcome 1, learners could find out about a range of costing systems via case studies and be given the opportunity to investigate their own organisations. Delivery could include other qualitative factors influencing pricing such as market forces.

Within learning outcome 2, there is a range of forecasting techniques. Learners who have not studied statistics before might find this quite challenging. There needs to be opportunity for learners to practise these techniques both within and outside of the classroom. It is also important that learners understand the rationale for each technique studied.

The delivery of learning outcome 3 needs to be as practical as possible. The aim is for learners to participate in the budgetary process. Therefore, the recommended form of delivery is to enable learners to practise. An important aspect of this process is the setting of targets. If their target setting is flawed, this should not stop learners gaining credit for later techniques – ie if they have used the targets they originally set.

In learning outcome 4, there are some quite challenging theories, although learners may have come across them in previous studies. The use of case studies, where the application of the techniques can be clearly seen, could be very useful.

In learning outcome 5, learners need time to practise investment appraisal techniques. However, the use of financial appraisal techniques to make decisions, needs to be given the greater emphasis in both teaching and practical exercises. It would also be useful to make links to specific organisations and their objectives. For example, if an organisation has difficulty getting investment funds then payback may always take precedence.

Essential guidance for tutors needed to practise using financial ratios. For delivery purposes, the emphasis needs to be on how financial ratios can be used in decision making. This needs to include analysing what the organisation needs, for example greater profitability versus better liquidity.

In general, discussion of the validity of certain forecasts or investment projects, and/or the selection and presentation of financial information, can be used positively to illustrate social or ethical influences, or opportunity cost considerations which pervade most financial decisions.

Outline learning plan

The outline learning plan has been included in this unit as guidance and can be used in conjunction with the programme of suggested assignments.

The outline learning plan demonstrates one way in planning the delivery and assessment of this unit.

| Topic and suggested assignments/activities and/assessment |
|---|
| Introduction to unit and programme of assignments |
| Tutor input – absorption and marginal costing and their relationship to price Practice exercises |
| Practical exercise – pricing policies and when marginal costing is most appropriate as a basis |
| Assignment 1: Systems and Prices |
| Tutor input – forecasting techniques and their uses |
| Practical exercises – forecasting techniques (and practice out of class) |
| Tutor input – role of budgeting in an organisation and link to forecasting with class discussion on own experiences |
| Practical exercises – building from functional to master budgets |
| Assignment 2: Master Budgets |
| Tutor input – cost reduction |
| Group work and learner presentations – cost reduction |
| Tutor input and class practice – activity-based costing |
| Assignment 3: Cost Reduction |
| Tutor input – capital investment, its risks and impact |
| Tutor input – making investment decisions with use of case studies |
| Assignment 4: Investment Appraisal |
| Tutor input – financial statements and their interpretation |
| Tutor input – case study on the interpretation of financial statements |
| Tutor-led discussion on limitations and uses of interpretation of financial statements |
| Assignment 5: Financial Analysis |
| Review of unit and programme of assignments |

Assessment

For this unit, where possible, learners should use information, examples and research from their own organisations or one that they are familiar with.

Learners should provide clear explanations of the function of forecasting and appraisal tools in the managerial decision-making process, giving relevant examples of current business practice. Learners should be able to demonstrate the use of forecasting techniques and interpret information arising from project appraisal and calculate ratios, using appropriate spreadsheet presentations.

For AC1.1, learners need to explain the importance of costs in the pricing strategy of their chosen organisation.

For AC1.2, the costing system that learners design must be appropriate for use in the organisation they are designing the system for. In order to show full understanding, learners could describe other systems they considered in this process and explain the reasons behind their final design. There must also be evidence of research into cost classifications and control mechanisms.

In AC1.3, learners need to propose improvements to the costing and pricing systems used in their chosen organisation. They could justify their recommendations by stating the benefits their proposed improvements would bring to the organisation.

For AC2.1, learners need to apply forecasting techniques to make cost and revenue decisions in/for their chosen organisation. The assessment should give learners the opportunity to utilise a range of techniques. Learners will need to state why they used a particular technique, the limitations of the technique, and how the information derived from applying the technique can be used to make cost and revenue decisions.

For AC2.2, learners need to assess the sources of funds available to their chosen organisation for a specific project. The assessment should give the opportunity to research a range of possibilities for funding.

For AC3.1, it might be useful if an assessment also covers AC2.1. Learners can use forecasting techniques as part of the process of selecting appropriate budgetary targets for their chosen organisation. Learners need to explain why the budgetary targets they have selected are appropriate for their chosen organisation.

For AC3.2, learners need to demonstrate how they have participated in the creation of a master budget in/for their chosen organisation.

For AC3.3, learners need to compare actual expenditure and income to the master budget of their chosen organisation. This may involve calculating budget variances and articulating what they mean and what might have caused them. They should also be able to judge the materiality of the variances.

When evaluating the budgetary monitoring processes in their chosen organisation for AC3.4, learners should be able to recognise the generic limitations of budget variances and how this might be different for types of budgets, for example fixed versus flexible.

For AC4.1, the recommendations should take account of the idiosyncrasies of the organisation in question. Learners should consider at least three processes that could manage cost reduction before making any recommendations. Learners need to explain the difficulties that may need to be overcome when implementing the recommended processes.

For AC4.2, in order to evaluate the potential for the use of activity-based costing, learners will first need to describe what it is and explain how it works.

For AC5.1, learners need to demonstrate how they have applied financial appraisal methods to analyse competing investment projects in the public and private sector. Learners need to compare and analyse a minimum of two projects in each sector and apply a minimum of three appraisal methods. They need to use some of the results from this analysis exercise to make a justified strategic investment decision for an organisation (AC5.2). They must also show that they can use sensitivity analysis and relevant qualitative information when making their investment decision.

A different scenario could be used for AC5.3. Learners should already have information from a post-audit appraisal of a strategic investment decision made in an organisation, and they should supply the strengths and weaknesses of the investment decision before making conclusions on its appropriateness.

For AC6.1, learners will not need to produce the financial statements. Their analysis should utilise at least three different financial statements when assessing the financial ability of their chosen organisation.

For AC6.2, the ratios applied to improve the quality of financial information in their chosen organisation need to cover liquidity, profitability and efficiency with at least two in each category.

For AC6.3, learners need to make recommendations on the strategic (rather than operational) portfolio of their chosen organisation. They need to include the alternatives that were considered before arriving at the recommendations.

Where work-based assignments are not possible, case studies could be used so that learners have the opportunity to successfully meet the assessment criteria.

Programme of suggested assignments

The table below shows a programme of suggested assignments that cover the criteria in the assessment grid. This is for guidance only and it is recommended that centres either write their own assignments or adapt Pearson assignments to meet local needs and resources.

| Assessment criteria covered | Assignment title | Scenario | Assessment method |
|---------------------------------|----------------------|------------------------------|-------------------|
| AC 1.1, 1.2, 1.3 | Systems and Prices | Case study (classroom based) | Report |
| AC 2.1, 2.2, 3.1, 3.2, 3.3, 3.4 | Master Budgets | Case study | Report |
| AC 4.1, 4.2 | Cost Reduction | Case study | Report |
| AC 5.1, 5.2, 5.3 | Investment Appraisal | Case study | Report |
| AC 6.1, 6.2, 6.3 | Financial Analysis | Case study | Report |

Essential resources

There are no essential resources required for this unit.

Indicative resource materials

Textbooks

Atrill P and McLaney E – *Management Accounting for Non-specialists, 3rd Edition* (Financial Times/Prentice Hall, 2002) ISBN 0273655914

Berry A and Jarvis R – *Accounting in a Business Context, 4th Edition* (Cengage Learning EMEA, 2005) ISBN 1844802515

Brookson S – *Managing Budgets* (Dorling Kindersley, 2000) ISBN 0751307718

Cox D and Fardon M – *Management of Finance* (Osborne Books, 1997) ISBN 872962238

Drury C – *Management Accounting for Business, 4th Edition* (Cengage Learning EMEA, 2009) ISBN 1408017717

Glynn J, Perrin J, Murphy M and Abraham A – *Accounting for Managers, 3rd Edition* (Thomson Learning, 2003) ISBN 186152904X

Harris R and Sollis R – *Applied Time Series Modelling and Forecasting* (John Wiley and Sons, 2003) ISBN 0470844434

Lumby S and Jones C – *The Fundamentals of Investment Appraisal* (Thomson Learning, 2000) ISBN 1861526075

Monden Y – *Cost Reduction Systems: Target Costing and Kaizen Costing* (Productivity Press, 1995) ISBN 1563270684

Makridakis S, Wheelwright S C and Hyndman R J – *Forecasting, 3rd Edition* (John Wiley and Sons, 1998) ISBN 0471532339

Pettinger R – *Investment Appraisal: A Managerial Approach* (Palgrave Macmillan, 2000) ISBN 0333800591

Secrett M – *Mastering Spreadsheets, Budgets and Forecasts, 3rd Edition* (Financial Times/Prentice Hall, 1999) ISBN 0273644912

White G I, Sondhi A C and Fried D – *The Analysis and Use of Financial Statements, 3rd Edition* (John Wiley and Sons, 2003) ISBN 0471375942

Yoshikawa T, Innes J and Mitchell F – *Strategic Value Analysis* (Financial Times/Prentice Hall, 2002) ISBN 0273654292

Journals/newspapers

Newspapers can be a useful source for financial issues in both the private and public sector. Examples include *The Financial Times*, *The Guardian*, *The Independent* and *The Times*.

Specialist periodicals also provide current articles on developments in related topic areas. Examples include:

Management Accounting Quarterly (Institute of Management Accountants)

Management Today (Haymarket Business Media)

Strategic Finance (Institute of Management Accountants)

Websites

There are many websites that provide useful information, case studies and examples of the application of financial techniques in business situations. Company reports can be accessed and ordered through the *Financial Times* website or through the Registrar of Companies, whose website contains useful information on the style of reporting for company accounts and information on the content of company reports. Public limited companies have websites which normally give access to their published accounts and accompanying reports.

Most of the professional accounting bodies (CIMA, ICA, CIPFA, AAT) have their own websites with access to library facilities (although if you are not a member, access may be restricted).

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| www.aat.co.uk | Association of Accounting Technicians |
| www.bized.co.uk | Learning materials and a wide range of company information |
| www.cimaglobal.com | Chartered Institute of Management Accountants |
| www.cipfa.org.uk | Chartered Institute of Public Finance and Accountancy |
| www.companies-house.gov.uk | Companies House |
| http://corporate.marksandspencer.com | Example of company website containing information on its published accounts |
| www.guardian.co.uk | Example broadsheet newspaper website |
| www.icaew.co.uk | Institute of Chartered Accountants in England and Wales |
| www.icsa.org.uk | Institute of Chartered Secretaries and Administrators |
| www.thetimes100.co.uk | Company case studies |