Advance Bookkeepers (Management accounting and Cashflow)

Presenter: Thabo Malema

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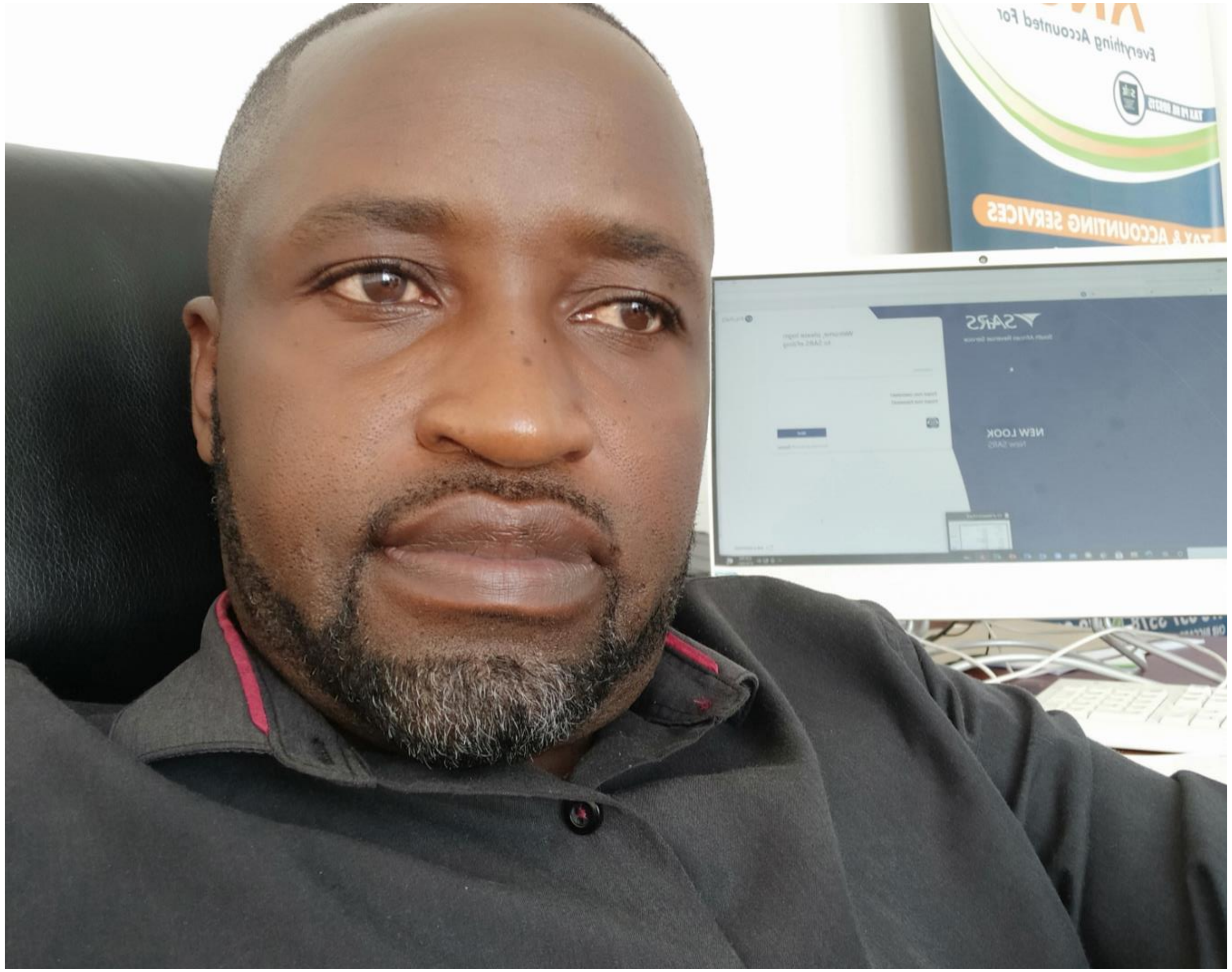
Thabo Malema

Thabo Malema is a director at Tax and Accounting Angel, an accounting firm based in Polokwane. An experienced entrepreneur, Thabo also holds directorship in various other companies.

Thabo holds a National Diploma in Financial Accounting and is also a registered Tax Practitioner. Other business interests that he is involved in include real estate and life coaching. He is a registered realtor who sells both residential and commercial properties in Polokwane. Thabo believes that nothing in this world can limit his drive for success in any chosen field that he participates in.



Course Outline

Learning objectives

- Understanding the importance of management accounting and cashflow in every business survival
- Knowing which management accounting techniques can be used effectively during slump economy
- Understand how to manage overheads
- Understand why it is important to prepare regular management accounting reports and
- Know how to prepare useful management accounting reports

CONTENT

- The difference between management and accounting and financial accounting
- Management accounting explained
- Costing and budgeting
- Practical budgeting techniques
- Cash flow forecasting
- The concept: Cost (Controlling costs)
- Preparation of regular management accounting report

Management VS Financial Accounting

AUDIENCE

FOCUS

FREQUENCY

- ❑ Internal, e.g Managers, Executives, employees, unions
- ❑ Future decision making
- ❑ Management needs
- ❑ Relevance and flexibility
- ❑ Timeliness
- ❑ Detailed departmental reports, products, customers or employees – management accounts
- ❑ Not mandatory

- ❑ External e.g shareholders, creditors, sars, government agencies, clients, Bank
- ❑ Past financial period
- ❑ Annually
- ❑ Verifiability of financial information
- ❑ Must adhere to the reporting standards
- ❑ Periodic reports, AFS
- ❑ Mandatory (IFRS, BS, PNL, Changes in equity, cash flow statement, accounting policies and explanatory notes)

MANAGEMENT ACCOUNTING EXPLAINED

- Business enterprise has accounting system that collects and processes financial information to users
- The communication of financial information is known as financial reporting
- The objective of financial reports is to supply useful and understandable financial information to the users (Both internal and external)
- Internal decision makers are the management of the business
- They require continuous detailed information in order to plan and manage the daily business operations
- Developing accounting information for internal decision makers is a separate field known as Management Accounting
- Whereas developing accounting information to the external users is called Financial Accounting

COST AND BUDGETING

- Costs are technically essential and economically unavoidable expenses for the production of goods and services
- Expenses refer to the value offered but its effectiveness has not yet been determined, as soon as they are effectively applied, they are classified as costs
- When the expenses have not been effectively applied, we call them wastage(loss)
- Costs are a necessary sacrifice in order to deliver a product or service
- Costing is a process in which a company attempts to estimate the costs involved in the production of one unit of output
- Costing requires the use of historical information to predict the future

Classification of costs

1. Expired and Unexpired costs

1.1. EXPIRED COSTS

- An expired cost is a cost that has been recognized as an expense
- This happens when an entity fully consumes or receives benefit from a cost
- An expired cost may also be construed as the total loss in value of an asset
- A cost for which a portion is still recorded as an asset and a portion has been recognized as an expense can be considered a partially expired cost.
- E.g A company purchases a truck for R100 000. The truck depreciates at 20% per annum for 5 years on a straight-line method

1.2. UNEXPIRED COSTS

- An unexpired cost is any cost that has not yet been charged to expense because it still represents some residual value
- This cost is frequently associated with revenue that has not yet been recognized; under the matching principle, an unexpired cost is maintained on the books as an asset until the associated revenue is recognized, at which point the asset is charged to expense.

Expired and unexpired costs continued

COST

Expired Costs

Recorded as an expense in the P & L account of the current accounting period

Unexpired Costs

Recorded as an asset in the balance sheet and becomes an expense in the P & L statement in a later accounting period

BUDGETING

Definition - budget is an estimation of revenue and expenses over a specified future period of time. A budget is basically a financial plan for a defined period, normally a year

- Every institution, public or private, or individuals draw a budget

BUDGETING

- Refers to the plan to acquire revenues and incur expense in a defined period of time

1. ZERO BASED BUDGETING

- most commonly used budgeting method
- zero-based budgeting starts with the assumption that the company's budgets are zero and must be rebuilt from scratch
- Managers must be able to justify every single expense.
- Zero-based budgeting is very tight, aiming to avoid any and all expenditures that are not considered absolutely essential to the company's successful (profitable) operation. This kind of bottom-up budgeting can be a highly effective way to step out of the traditional expenditure patterns
- The zero-based approach is good to use when there is an urgent need for cost containment, for example, in a situation where a company is going through a financial restructuring or a major economic or market downturn that requires it to reduce the budget dramatically
- Zero-based budgeting is best suited for addressing discretionary costs rather than essential operating costs. However, it can be an extremely time-consuming approach, so many companies only use this approach occasionally

2. Activity-based budgeting

- Activity-based budgeting is a top-down budgeting approach that determines the amount of input required to support the targets or outputs
- For example, a company sets an output target of 50 million in revenues
- The company will need to first determine the activities that need to be undertaken to meet the sales target, and then find out the costs of carrying out these activities

3. Value proposition budgeting

- In value proposition budgeting, the budgeter considers the following questions:
  - Why is this amount included in the budget?
  - Does the item create value for customers, staff, or other stakeholders?
  - Does the value of the item outweigh its cost? If not, then is there another reason why the cost is justified?

- Value proposition budgeting aims to avoid unnecessary expenditures

4. Incremental budgeting

- Incremental budgeting takes last year's actual figures and adds or subtracts a percentage to obtain the current year's budget
- It is the most common method of budgeting because it is simple and easy to understand. Incremental budgeting is appropriate to use if the primary cost drivers do not change from year to year.

PRACTICAL BUDGETING TECHNIQUES

Imposed budgeting

- Imposed budgeting is a top-down process where executives adhere to a goal that they set for the company
- Managers follow the goals and impose budget targets for activities and costs
- It can be effective if a company is in a turnaround situation.

Negotiated budgeting

- Negotiated budgeting is a combination of both top-down and bottom-up budgeting methods
- Executives may outline some of the targets they would like to achieve but at the same time, there is shared responsibility for budget preparation between managers and employees
- This increased involvement in the budgeting process by lower-level employees may make it easier to adhere to budget targets, as the employees feel like they have a more personal interest in the success of the budget plan

Participative budgeting

- Participative budgeting is a roll-up approach where employees work from the bottom up to recommend targets to the executives
- The executives may provide some input, but they more or less take the recommendations as given by department managers and other employees.
- Operations are treated as autonomous subsidiaries and are given a lot of freedom to set up the budget.

CASH FLOW FORECASTING

- What is a cash flow forecast?
- Understanding your cash flow is vital
- A cash flow forecast is a document that helps estimate the amount of money that'll move in and out of a business
- It also includes projected income and expenses. Cash flow forecasts typically covers the next 12 months, but can also be used for shorter periods of time – like a week or a month

What should be included in a cash flow forecast?

There are three key elements to include in a cash flow forecast:

1. Estimated likely sales

- To start, you need to estimate your likely sales for the weeks or months covered by your cash flow forecast
- The easiest way to do this is to look at your sales history from the last few years
- Take note of any seasonal patterns, or the impact of promotions you have run in those months.
- If you're just starting your business, then you can use data from suppliers, industry experts and even competitors to make predictions
- When estimating these sales, it's important to take any future plans into consideration too
- Take a look at the current state of the market and any emerging trends, as these may have an impact on your business
- Things to consider include any promotional activity or product launches, and the activity of competitors too

Why use a cash flow forecast?

- Cash flow forecasts are primarily used to help the business owners plan how much cash they'll need in the future
- Cash flow forecasts can:
- Show you whether your business is meeting expectations
- By comparing your actual income and expenses with your forecast, you can see which areas of your business are over or under performing and act accordingly
- Help you budget for equipment purchases or identity the need for a small business loan, which is very useful for your tax preparation
- Be adapted to see the effects of planned business changes. If you're planning on hiring for example, you can add the salary and related costs to see how it'll affect your business's financial position
- If a business runs out of cash (and can't get a loan or funding) it will become insolvent. This means that its liabilities exceed its assets, unless its ongoing revenue covers its debt obligations
- With some effective cash flow forecasting, however, things shouldn't get to that stage.

2. Projected payment timings

- Once your estimated sales are in place, you need to add in when you expect payments to be received
- Factor a delay for most payments (most payments are usually 2 weeks late)

3. Projected costs

- Estimate the payments
- There will be variable and fixed costs
- Fixed costs include rent and salaries, and will stay the same regardless of how much you earn. Add these dates and projected amounts, including bills, fees, memberships and tax payments
- Variable costs are the opposite – they're usually dependent on the sales made. For example, stock or raw materials. In this instance, you can use your likely sales to predict how much these costs will be.
- Cash flow forecasts are pretty easy to prepare. The key is to keep them up-to-date and relevant.

Why are cash flow forecasts important?

- Accurate and timely cash flow forecasting is important for a number of reasons:
- By forecasting your income and budgeting accordingly, you can ensure suppliers and employees are paid on time.
- This'll help avoid nasty situations like losing a supplier
- By calculating how much cash the business will have at the start of the month, cash flow forecasts can act as an early warning for future issues. This can help identify the need for a loan or overdraft far in advance.
- Banks, investors and so on will usually want to examine a business's cash flow forecast (among other documents) before investing in them or providing a loan. A professional and thorough cash flow forecast is a great way to win over external stakeholders.

ELEMENTS OF THE CASH FLOW STATEMENT

- ❑ Operations – when there is an increase in the operations income it shows that the company is growing
- ▪ If the income is lower it means the company is shrinking
- ▪ If the income is negative, the company is in the verge of collapse and needs urgent intervention

- ❑ Investing activities – is the money spent on acquisition of the of property and investment proceeds
- ▪ Usually this statement is negative as it represents investment/ purchase of the property
- ▪ However it can be positive if the company is receiving income from its investment or sells its property

- ❑ Financing activities – A positive financing activity means that the company is raising money, possibly to fund its operations
- ▪ A negative financing statement may mean the company is paying shareholders the dividends or repaying the creditors to lower the debt level

CASH FLOW STATEMENTS

- Refers to the movements of money into and out of the business
- Alongside the balance sheet and the statement of income, it is a mandatory statement to the financial report
- It provides users with the information about the actual sales income, investments and financing

- Cashflow statement can be traced back to the Fourth Schedule of the companies Act of 1973

- The object of this Act was to oblige companies to report on the source and application of funds

- To date, cash flow statement is a requirement by the IFRS

CONTROLLING COSTS

- Reduction of expenses (Variable or Fixed?)
  - Personnel
  - Water, electricity

- Expansion (*Special packages, price reduction/ increasing the duration at the same rate*)

- Take advantage of available incentive e.g *ETI – cost sharing mechanism with the government*

- Outsourcing

CONTROLLING COSTS (*Continued*)

- Cost control by management means a search for better and more economical ways of completing each operation
- Cost control is simply the prevention of waste within the existing environment
- This environment is made up of agreed operating methods for which standards have been developed
- These standards may be expressed in a variety of ways, from broad budget levels to detailed standard costs
- Cost control is the procedure whereby actual results are compared against the standard so that waste can be measured and appropriate action taken to correct the activity
- Cost control is defined as the regulation by executive action of the costs of operating an undertaking Cost control aims at achieving the target of sales
- Cost control involves setting standards
- The firm is expected to adhere to the standards
- Deviations of actual performance from the standards are analysed and reported and corrective actions are taken
- It seeks to attain lowest possible cost under existing conditions. Cost control is a preventive function.

Aspects of Cost Control:

Cost control involves the following steps and covers various aspects of management

- **Planning**

Initially a plan or set of targets is established in the form of budgets, standards or estimates

- **Communication**

The next step is to communicate the plan to those whose responsibility is to implement the plan.

- **Motivation**

- After the plan is put into action, evaluation of the performance starts
- Costs are ascertained and information about achievements is collected and reputed
- The fact that the costs are being reported for evaluating performance acts as a prompting force

- **Appraisal**

  - Comparison has to be made with the predetermined targets and actual performance
  - Deficiencies are noted and discussion is started to overcome deficiencies

- **Decision-making**

  - Finally, the reported variances are received
  - Corrective actions and remedial measures are taken or the set of targets is revised, depending upon the administration's understanding of the problem

PREPARATION OF REGULAR MANAGEMENT ACCOUNTING REPORTS

- The purpose of the management reports is to provide management with relevant information to enable them to take sound management decisions
- The frequency of the management report is determined internally
- The format of the report would differ from one company to the next
- Management accounts may include the following:

✓ Key performance indicators
✓ Profit and loss statement
✓ Balance sheet
✓ And cash flow statement

- The management can request any type of report from finance to human resource and processes and procedures in operation

CONCLUSION

- Johnson and Kaplan wrote a book in the 80s – Relevance Lost – the rise and fall of Management Accounting
- This was a response to much criticism from scholars at that time
- They argued that Management Accounting information is just an extraction from organization's accounting system instead of being generated by an independent, purpose-made system
- That there is lack of innovation in the discipline
- Vast improvements were made since the criticism

THANK YOU!!!