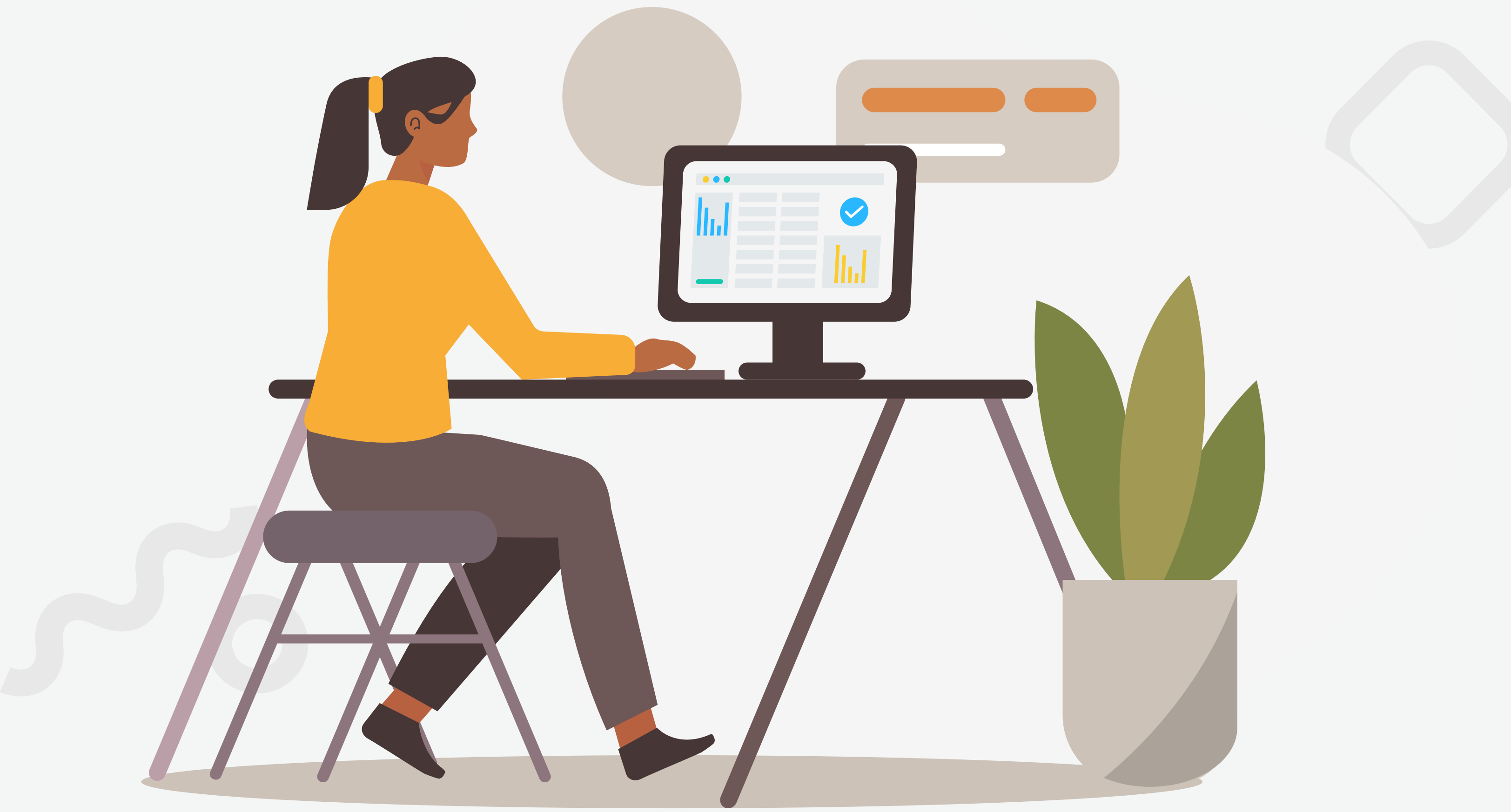
Skillbook

Finance Management

Career Skills



mindtools

Finance Management
Skillbook

This Skillbook is published by Mind Tools Ltd.
21 Young Street, Edinburgh, Scotland, EH2 4HU.

Version 5.0.

If you have any queries, please contact us at mtecustomerservices@mindtools.com.

Contents

1. Introduction

The world of finance can be a mysterious and complex one, particularly if you have little or no experience of it.

If you sometimes feel intimidated by financial reports filled with tightly packed rows of numbers and complex graphs, don't worry – you're not alone. In many organizations, managers outside the finance department don't need to know every single fact and figure. However, a good, basic grasp of finance is important whatever your career, and when you make big life decisions, too.

Finance management is about much more than controlling the flow of money. A good understanding of what your finance team does, as well as the key reports they produce and what they can tell you, can help you to make better financial decisions that benefit both your team and your wider organization.

And, if you think about it, these decisions aren't just down to the people working in the finance department. In fact they are made every day by anyone who is managing a budget or setting up a new project, or who wants to make a new investment.

In this Skillbook, you'll learn:

- The basics of financial management and why it's important to you and your organization.
- More about the roles and responsibilities of your finance team.
- Key financial terms and reports, why they're important and how to use them.

2. Finance Management and Why It's Important

Financial management is the reporting, allocation, acquisition, and utilization of financial resources to support a business' strategy.

Note that the definition above doesn't mention "profit." Financial decisions are, in fact, based upon the organization's strategic direction, and its desire to grow and remain competitive. This strategy is commonly set by the shareholders and investors, as it is their resources that are being deployed.

Organizational strategy could, of course, be about driving profit, but it could also be about using profit to invest and build a brand portfolio or enter new markets.

Specifically, finance management involves some or all of the following:

- Analyzing the financial situation, internally and externally.
- Making financial decisions.
- Setting financial goals and objectives.
- Developing financing plans.
- Providing effective finance systems and processes.
- Seeking value through cost savings and efficiencies.

Finance management is not an isolated function, nor is it the sole responsibility of the financial controllers in your organization.

If, for example, you're a manager or part of your role involves managing a budget, sound finance management skills will help you to identify areas where your organization or department is performing well, and where it is not; as well as where savings could be made or where further investment is needed.

Not only will this help you to make good business decisions, but it will also mean that you are doing your part to secure the long-term financial health of your organization.

Action:

Thinking about what we've learned so far about finance management, write down three reasons why you believe it's important in your organization.

Why Is Finance Management Important in My Organization?

Action:

Now, think about your role and how it relates to the finance management of your organization. Then, answer the following two questions.

What Decisions Do I Make That Are Related to Finance Management?
How Will Understanding More About Finance Management Help Me to Perform Better?

3. The 10 Fundamental Functions of Finance

The finance department's main purpose is to provide financial expertise and ensure that the business achieves its key financial goals.

The size of your finance department will depend on the size of your organization. Senior managers in your finance team may have different titles, such as Chief Financial Officer (CFO), Treasurer, Controller (or Comptroller), or Finance Manager.

The larger your organization, the more likely it will be to have specialist financial functions, such as investment managers, risk managers or taxation specialists. But, if yours is a smaller organization, people will likely have broader responsibilities that encompass many different areas of finance.

The people who work in the finance department will be involved in almost every business decision that your organization makes – from setting financial goals and budgets, to advising on investments and managing risks.

Action:

Think about the finance department in your organization. Write down what you think its top 10 responsibilities and functions are.

Once you've done this, check how your answers compare with the 10 key functions of finance listed on page 6. Did you get any wrong? Or miss any out?

Top 10 Functions of the Finance Department
1.
2.
3.
4.
5.
6.
7.
8.
9.
10.

The 10 Fundamental Functions of Finance

Whether your organization is a large corporation or a small business, your finance department will likely be responsible for the following 10 key functions:

1. Creating budgets and budget forecasts.
2. Producing statutory financial reports and statements.
3. Preparing management accounts.
4. Cash flow monitoring and treasury.
5. Developing and managing secure financial systems.
6. Managing financial transactions.
7. Paying taxes.
8. Advising on corporate objectives and organizational strategy.
9. Advising and deciding on investment decisions.
10. Business partnering.

1. Creating Budgets and Budget Forecasts

Essentially this involves setting expectations for the year, and forecasting likely profit and cash flow. Board members can then establish what needs to be achieved in the year ahead, what investments are needed, and what dividends are anticipated.

2. Producing Statutory Financial Reports

Formal financial reporting is not only critical in enabling key stakeholders to assess organizational performance, but it's also necessary to meet mandatory reporting and accounting standards, too. This is important to ensure that meaningful comparisons can be made between companies.

These reports are often audited externally (unless an exemption exists). Audits ensure that stakeholders can have trust in and rely on the numbers that have been produced and that they depict a true picture of the company's financial health.

Tip:

Audit exemptions exist for some businesses, but these can vary depending on the country that you live in. For example, in the U.K., an exemption occurs if a business has fewer than 50 employees or a turnover below £10.2m). In the U.S., only public companies have to be audited.

3. Producing Management Accounts

This includes preparing weekly or monthly financial statements for internal reporting purposes only. These types of accounts may focus on financial performance, as well as other key performance indicators (KPIs), and allows an organization to monitor its progress over time.

It also enables stakeholders to see how the actual figures are comparing to those budgeted, and can help them to decide whether their financial objectives are still sensible or whether they need to be re-forecast.

4. Cash Flow and Treasury

This refers to the process of monitoring, analyzing and optimizing the cash flow (or working capital) in an organization. This means ensuring that sufficient and appropriate financing is in place so that the organization can pay its employees and suppliers.

If a company is doing particularly well and has a high cash flow, this can also be re-invested into the business. For example, to pay off loans or finance new projects.

To monitor cash flow effectively, companies draw up Cash Flow Statements (see page 22)

5. Developing and Managing Secure Financial Systems

Financial management systems (FMS) refers to the software and processes an organization uses to manage assets, income and expenses.

These systems ensure that there is a rigorous control environment in place that:

- Reduces accounting errors.
- Maintains auditing trails.
- Detects and prevents fraudulent activity.
- Ensures compliance with accounting standards.

Larger organizations, which are audited more frequently and where the need for rigorous financial risk management systems is higher, tend to have an internal audit department dedicated to managing and monitoring FMS, and ensuring compliance.

Action:

Secure financial systems are essential in detecting and preventing fraud and ensuring compliance in any business. But what does "fraud" entail?

Use the spaces below to write down five types of fraudulent activity that a company risks allowing if it doesn't have effective finance management systems in place. (Find our answers on page 25).

Five Types of Fraud Risk That Could Impact an Organization
1.
2.
3.
4.
5.

6. Managing Financial Transactions

One of the key day-to-day responsibilities of any finance department is to ensure that financial transactions are completed smoothly, efficiently and on time.

These types of financial transactions may include:

- Payments to suppliers
- Payments from clients and customers.
- Payroll processing.
- Expense claims.

7. Paying Taxes

Tax laws vary from place to place, and they can be highly complex. But, wherever there is a government, there are taxes to be paid!

So, it's vital that correct systems are in place that enable an organization to file and pay its taxes correctly.

8. Advising on Corporate Objectives and Organizational Strategy

This refers to managing and using the company's finances to help it achieve its goals and objectives, and to maximize shareholder value over time. It involves continuously monitoring, analyzing and readjusting goals to keep the company focused on its long-term strategy.

Some of the more common elements of this function include:

- **Planning:** defining specific objectives, writing business plans, and identifying and quantifying potential resources.
- **Budgeting:** setting specific, departmental budgets that help the organization to meet its wider objectives, while maintaining financial efficiency and reducing waste.
- **Managing and assessing risks** – identifying, analyzing and mitigating risks involved in investment and budgeting decisions.
- **Monitoring the external environment** – identifying changes in the market and the wider financial environment, and ensuring that the organization is prepared for any such changes.

9. Advising and Deciding on Investment Decisions

Investment decisions relate to how much an organization should invest, and what specific assets it should invest in. These types of decisions may include:

- **Capital budgeting:** deciding whether projects are worth developing from a financial perspective.
- **Valuing investments:** using present value, opportunity cost of capital, and future value, to make sure that money is well spent.
- **Assessing project risks:** this involves identifying and managing any financial risks involved, as well as potential payoff, and establishing whether it is likely to return enough of a profit to justify the risk.
- **Identifying assets:** particularly those that are worth more than they cost, and which give a sufficient return on that cost.
- **Ethical decision making:** many companies seek to align profits with principles, which means seeking out investment opportunities that are sustainable and ethical. For example, those that focus on the environment or climate change.

Action:

Think about the different types of investment decisions that an organization can make. Now, write down any key investment decisions that you know your organization has made in the past year, in the space provided below.

For example, has it acquired another business or expanded into a new market?

If you don't know of any, write down who you could ask or where you could go to find out more about the investments your organization has made, as well as any acquisitions or pension funds.

Investment Decisions I Know About	
Where Could I Go or Who Could I Ask to Find Out More About the Following?	
Investments	
Acquisitions	
Pensions	

10. Business Partnering

Business partners work closely with leaders across the business to provide them with sound financial advice on business activities, business cases, and organizational strategy. This could include advice on budget setting, forecasting, business-case planning, and investment appraisal, for example.

Business partnering enables teams from across the business to collaborate with internal finance professionals who often have a better "top-down" view of the organization, its strategy and goals, and how best to meet them.

In this way, corporate objectives can be effectively linked to departmental, and even individual, goals, thus ensuring a more purpose-driven organization.

Financial business partners can also help senior managers across the business to draw up effective and informed business cases that contain all the critical financial information needed.

Tip:

Business cases are essentially project proposals, designed to formally document the advantages, disadvantages, costs, risks, and benefits of a particular project or investment. Finance business partners are pivotal in helping senior managers to draw up accurate business cases that include the correct financial data needed to demonstrate the return of a project or investment.

If you want to learn more about business cases and how to create one, read our article, How to Write a Business Case.

In the next chapter, we'll look at the key financial terms that are used by organizations to monitor and manage performance and profitability.

4. Essential Financial Terms

Financial jargon can feel impenetrable at times. There's the opex, capex and EBITDA... if you're left scratching your head, don't worry!

In this chapter, we'll explain the key financial terms you'll need to know to gain a better understanding of your company's financial health. You can also use them to help you to make informed financial decisions and to manage your budgets more effectively.

Turnover, Revenue and Sales

Often the terms "turnover," "revenue" and "sales" (or "earned income") are all used interchangeably. It's true that turnover and revenue mean the same thing. However, sales refers to the money a business earns from the sale of its goods and services; while revenue (or turnover) is the total amount of money generated by a company. This means that revenue can be higher than sales if a business has other sources of income. Sales is therefore a subset of revenue.

In this instance, revenue is a good indicator of a company's ability to invest and allocate financial resources; while sales indicates the company's capability to sell its products and services.

Tip:

Sales invoicing can sometimes be different from "Earned Income." For instance, in the case of subscription services.

For example, if a client takes out an annual subscription to a cloud tech service, it may be invoiced upfront for the full amount – $24k. But the revenue is actually recognized over the life of that licence. This means only $2k will count as revenue in the first month, even though sales invoicing is reported as $24k.

EBITDA and Profit

EBITDA is a very common term used in accounting. It stands for: “Earnings, Before Interest, Tax, Depreciation and Amortization.”

Tip:

Amortization and depreciation are two ways of calculating an asset’s value over time.

Amortization is the spreading of an intangible asset’s cost over that assets’ useful life. Intangible assets might include a patent, a copyright or a franchise.

Depreciation is the expensing of a fixed or tangible asset over its useful life. This might include assets such as computer equipment or office furniture.

Put simply, EBITDA can be thought of as a measure of a company’s operating performance.

Because EBITDA ignores the impacts of non-operating factors, such as financing decisions (loans and interest), accounting decisions and policies (depreciation and amortization) or tax deductions, it can give a much clearer insight into a company’s actual profitability.

EBITDA Formula

EBITDA =

Revenue - Direct Costs - Overheads

To calculate EBITDA you simply take revenue, then subtract direct costs (e.g. machinery or plant costs) and overheads (e.g. staff salaries or office rental costs). Then you add back any depreciation, amortization, interest, and tax included in your overheads.

The EBITDA margin is another useful measure that businesses like to look at. This is EBITDA as a percentage of turnover. This measure is useful as it allows businesses to make year-on-year comparisons. For example, EBITDA might go up one year, but the EBITDA margin might decrease. This is an indicator that the business is working less efficiently than in the previous year and management will want to understand why that is – perhaps costs or expenses have increased recently, resulting in a lower EBITDA margin.

Accruals and Prepayments

You "accrue" an expense or cost when your business has received a product or service but hasn't yet received an invoice for it. Recording costs can help businesses to keep track of expenses over time.

Prepayments are the opposite of accruals – where the business has paid upfront for a product or service that it hasn't yet received. For example, an annual subscription payment.

CAPEX and OPEX

Any expense that a business incurs is classified under two headings:

1. Capital (or investment) expenditure (CAPEX).
2. Operating expenditure (OPEX).

Capital expenditure refers to business purchases of major goods and services that will be used to improve the company's performance over the long term. This might include:

- Property.
- Plant or machinery.
- Computers.
- Vehicles or trucks.

These expenditures depreciate over time, which means that the cost of the asset is spread out over the term of its "useful life." For example, a laptop might have a useful life of three years, which means that a computer costing $1,800 would depreciate to zero at a rate of $50 per month for that term.

In contrast, operating expenditure (OPEX) relates to costs that a business incurs from running its day-to-day operations.

Operating costs might include:

- Staff salaries.
- Printing costs.
- Travel costs.
- Rent and utilities.
- Staff training.

OPEX are usually short term. The economic benefits of the expenditure generally occurs within the accounting period (month or year) in which the costs were reported, which is why they are recognized immediately.

NPV, IRR and Paybacks

When a business needs to decide what budgets to set or whether to invest in a particular project, it will often look at a range of measures that can help it to assess whether the project will be worthwhile or not. In these instances, the company will likely look at one of these three measures:

NPV (Net Present Value)

NPV refers to the present value of cash flows at the required rate of return of your project, compared to your initial investment (or cash outlay).

The term "present value" is based on the fact that a dollar today is worth more than a dollar tomorrow. Why? Because a business can invest that money and start earning interest on it immediately.

This means that the investments an organization makes today should, in theory, produce more revenue in the future. The present value tells us how much our future income will be in today's dollars. It does this by accounting for the "time value of money" (denoted by *t* in the formula given below).

NPV can be very useful in financial planning, as it can help businesses to work out what its return on investment will be on a particular project or expenditure.

NPV Formula

$$\textbf{NPV} = \frac{R_t}{(1+i)t} - \text{Initial Investment}$$

where:

R_t = net cash flow at time (t)

i = discount rate

t = time of the cash flow

IRR (Internal Rate of Return)

The Internal Rate of Return is another good measure for determining the potential payoff of an investment.

It is a percentage "interest rate" that makes the NPV of all cash flows equal zero. In other words, it is the rate of growth that an investment is expected to generate.

If this sounds tricky to calculate, don't worry! Fortunately, most spreadsheet apps and scientific calculators can work out IRR for you, using built-in formulae.

Paybacks

In financial planning, payback essentially refers to the amount of time before a cash investment is recouped. Shorter paybacks would therefore be more desirable to investors. A company might, for example, make it a requirement that projects have a payback of five years or less. Any longer and the project gets automatically rejected.

One of the key benefits of using this measure is its simplicity, because you're basically asking, "When am I likely to see a return on my investment?"

However, there are some risks involved in using this measure. First, unlike NPV and IRR, it doesn't account for the time value of money. And, second, it could cause companies to only focus on projects with a quicker return and neglect those that have a slower return but a significantly higher payoff.

Working Capital

Working capital (also known as net working capital or NWC) is the difference between a company's current assets and its current liabilities.

It's a good measure of a company's liquidity – in other words its short-term financial health.

A company has a negative working capital if the ratio of current assets to current liabilities is less than one. If this is the case, it will likely struggle to grow and may have problems paying off its creditors. It may even go bankrupt.

When a company has a positive working capital, however, it's in a much better position to fund its day-to-day activities and invest in future projects that can help drive growth.

Tip:

To learn more about financial forecasting, including how to use NPV and IRR calculations, read our Skillbook, Financial Forecasting in Project Evaluation.

And if you want to learn even more about financial terms and what they mean, read our article, Financial Accounting.

Action:

Now it's time to test your knowledge!

On the following page are a list of some of the financial terms we've just covered. Without looking back, write down a short definition of each in one or two sentences, using the spaces provided.

Financial Term	Definition
Turnover (or Revenue)	
Prepayments	
Opex (Operating Expenditure)	
Net Present Value (NPV)	
Working Capital	

You'll most likely see the terms we've discussed in this chapter in your company's monthly or annual financial reports. So, in the next chapter, we'll take a look at the main types of financial report you'll need to know and what they can tell us about organizational performance.

5. Key Financial Reports

Financial reports can feel inscrutable. There are all those tightly packed lines of figures and percentages. How are you supposed to make sense of them all? What do they all mean?

Every organization needs to account for the money that it brings in and the money that it spends. This can help it to understand more about its financial performance over time, how it should plan for the future, and what goals it should set.

That is why financial reporting is so important. So, in this chapter, we'll look at the different types of financial reports you'll likely come across, how to decipher them, and what each can tell you about your organization's financial health. The three key financial reports we'll cover are:

1. Profit and Loss Account (or Income Statement).
2. Balance Sheet.
3. Cash Flow Statement.

The three financial reports listed above all have a different focus, though there are links between them. This means it's often necessary to look through all three of them to build up a true picture of the financial health of an organization.

1. The Profit and Loss Account (or Income Statement)

The P&L Account (also known as the Income Statement) summarizes a company's revenue, costs and profit

This statement shows you whether the income of an organization is greater than its costs. In other words, whether it's profitable or not.

An example of a P&L account for a fictional firm, Classy Clothes Co., can be found on the following page. You can also prepare your own P&L account using the template provided on page 27.

Example P&L Account for Classy Clothes Co.

12 Months Ending	December 31, 2019 ($000)	December 31, 2020 ($000)
Turnover		
Sales of Clothes and Footwear	600	650
Other Income	50	60
Revenues From Design Consultancy Services	250	350
Total turnover	900	1,060
Direct Costs		
Sales Commission	(40)*	(45)
Cost of Goods Sold (COGS)	(200)	(230)
Total Direct Costs	**(240)**	**(275)**
Gross Profit *(Turnover - Direct Costs)*	**660**	**785**
Gross Profit Margin *(Gross Profit as a % of Turnover)*	**73.3%**	**74.1%**
Overheads (Fixed Costs)		
Wages	(300)	(350)
Office Rental	(50)	(60)
Marketing	(20)	(25)
Technology	(15)	(15)
Other	(10)	(10)
Depreciation and Amortization	(8)	(10)
Interest	1	2
Total	**(402)**	**(468)**
Profit Before Tax *(Gross Profit - Overheads)*	**258**	**317**
Tax	(49)	(60)
Profit After Tax *(PBT - Tax)*	**209**	**257**
EBITDA *(Profit - Adjusted Overheads, excl. Depreciation, Amortization and Interest)*	**265**	**325**
EBITDA Margin *(EBITDA as a % of Turnover)*	**29.4%**	**30.7%**

*Please note in financial reporting, costs are typically shown as negative figures denoted by brackets ().

Balance Sheet

The Balance Sheet provides a snapshot of the financial viability of an organization. It does this by showing all of its assets and liabilities, what it owes and what it's owed, as well as money invested by shareholders.

The types of assets and liabilities typically included on a balance sheet are:

- **Current (short-term) assets** – these can be easily converted to cash within one year (if needed). They include things like amounts owing from customers, prepaid expenses and inventory (goods available for sale).
- **Long-term assets** – these aren't able to be liquidated within the next year. They can include long-term investments, property and machinery.
- **Current liabilities** – money that the company owes to outside suppliers, such as utility bills, rent and salaries. Current liabilities are short-term liabilities owed within one year (long-term liabilities are due at any point after one year).
- **Long-term liabilities** – these can include long-term debt, pension fund liabilities and deferred tax liabilities (taxes that have been accrued but won't be paid for another year).

Suppose the owners of a business invest $100,000 and place all the cash in the bank. On day one, the company's Balance Sheet would look like this:

Example of a Balance Sheet: Year One

Assets	$(000)	Equities	$(000)
Cash at bank	100	Owners' equity	100

Now suppose that after one year, the business position is as follows:

- Cash at the bank has increased to $400 due to a bank loan achieved on the strength of a business plan.
- The business owns an inventory of stock worth $100,000 (current assets).
- The business has sold goods and is currently awaiting a payment of $150,000 from debtors (also an asset).
- It has also invested in some new machines costing $50,000. After depreciation over the year, their value is $40,000. (They are considered tangible assets, as they are physical in nature).
- The business owes creditors $75,000 (a liability that it will need to pay out by the end of the year).
- The company has also taken out a bank loan of $500,000, but this is not due for repayment for five years (therefore this is a long-term liability).
- During the year, the business has made a profit of $105,000. This is added to the owners' equity. Similarly, any loss would have been deducted from their equity.

Following these changes, the company's balance sheet now looks very different (see table on the following page).

As you can see, the company has a working capital of $575,000. As this is positive, it suggests that the company's short-term financial health is good because it has sufficient liquidity to pay its short-term bills and finance internal investment for growth.

However, if this figure were negative, there would be significant concern that the company would be unable to meet its repayment and operating obligations without raising additional funding or disposing of its fixed assets.

You can draw up your own Balance Sheet using the template on page 28.

Example of a Balance Sheet: Year Two

Assets	**($000)**	**Equities**	**($000)**
Fixed Assets		Owners' Equity	10
Tangible	40	Profit for Year	105
Total Fixed Assets	**40**		
Current Assets			
Cash at Bank	400		
Stock	100		
Debtors	150		
Total Current Assets	**650**		
Current Liabilities			
Owed to Suppliers	(50)		
Payroll Taxes Due	(25)		
Total Current Liabilities	**(75)**		
Long-Term Liabilities			
Bank Loan	(500)		
Net Assets *(Total Fixed Assets + Total Current Assets - (Current Liabilities + Creditors Due After One Year))*	**115**		
Working Capital *(Current Assets - Current Liabilities)*	**575**	**Total Equity**	**115**

Cash Flow Statement

The Cash Flow Statement (or Statement of Cash Flows) shows the actual cash flow in and out of an organization. This is important because one of the key aims in any business is to create value for shareholders, which is determined by having a positive cash flow.

Positive cash flow indicates that a company is able to add to its cash reserves, which it can use to reinvest in the business, pay out money to shareholders or settle debts. A positive cash flow therefore demonstrates that a business has strong financial flexibility. Not only does this put the company in a better position to reinvest and grow, it also means it's better equipped to survive economic downturns or market instability.

On a Cash Flow Statement, cash flow is segmented into three different areas:

- **Operating cash flow:** all cash generated by a company's regular business activities.
- **Investing cash flow:** cash generated or spent on investment activities, such as the purchase or sale of assets and securities.
- **Financing cash flow:** all proceeds gained from issuing debt, equity and dividends, as well as capital lease obligations.

See page 23 for an example of a Cash Flow Statement for Classy Clothes Co., (profit figures are based on those given in the P&L account shown on page 19).

If you want to create your own Cash Flow Statement, you can use the template on page 29.

Tip:

Cash flow is very different from profit. For example, a large transactional amount may be counted as revenue as soon as an invoice is sent out to a customer, but the actual cash from this deal may not be received for several months (depending on contract terms).

Example Cash Flow Statement for Classy Clothes Co.

	December 31, 2019 (£000)	December 31, 2020 (£000)
Cash Flow From Operating Activities		
Profit Before Tax	258	317
Net interest	(1)	(2)
Operating Profit	**257**	**315**
Depreciation and Amortization	8	10
Working Capital Movements	50	60
Net Cash Generated From Operating Activities	**315**	**385**
Investing Cash Flow		
Investments in Property and Equipment	(30)	(45)
Total Cash Used in Investing Activities	**(30)**	**(45)**
Financing Cash Flow		
Issuance (Repayment) of Debt	0	(100)
Issuance (Repayment) of Equity	0	0
Total Cash From Financing	**0**	**(100)**
Net Increase/(Decrease) in Cash *(Total Operating Cash - Total Cash From Investing - Total Cash From Financing)*	285	240
Opening Cash Balance	250	535
Closing Cash Balance	**535**	**775**

Tip:

The knowledge you've learned about financial terms and statements can also help you to manage your own personal finance.

6. Key Points

Finance management is key to understanding an organization's performance. But it's not only about the "bottom line."

Ultimately finance management is what enables and drives organizational strategy. It helps us to make informed decisions about the budgets and goals that we should set, or investments we should and shouldn't back.

It's also key to increasing the value and profitability of an organization, and ensuring that it is able to fulfill its financial obligations. For example, paying staff and suppliers on time, as well as dividends to investors.

That is why it's so important that you have a good, basic understanding of what the finance department does, as well as the key responsibilities it has, and the financial terms and reports it uses. This knowledge can help us to build up a better picture of how organization is performing, where it can do better and where it's heading in the future.

Answers and Templates

Answers to Exercise (page 7)

Types of Financial Fraud Risk That Can Affect an Organization	
Embezzlement (also known as larceny)	The misuse of funds by the people who control them. For example, an accountant who uses their client's money for their own personal needs. Embezzlers might also create bills or receipts for activities that did not occur to disguise the transfer of funds to themselves as legitimate (this is also known as "skimming"). Ponzi schemes are a type of embezzlement. In these schemes, the embezzler scams investors by using assets they've been entrusted with for the purposes of investment for their own personal use. To maintain the fraud, the embezzler often needs to seek out new investors to appease prior investors.
Internal Theft	This involves the stealing of organizational assets by employees. It could include taking offices supplies or products that the company produces without paying for them. One key indicator of internal theft is a drop in inventory, which is why controls such as regular inventory audits are so important.
Corruption	This entails dishonest behavior by managers or those in positions of power. It can include the giving or taking of bribes or inappropriate gifts, double-dealing or insider trading, diverting funds, money laundering, or defrauding investors. If unchecked, corruption can lead to increased criminal activity or organized crime. Many businesses work to prevent corruption through internal training on bribery and ethics, strict reporting procedures (for example, to monitor the receipt of corporate gifts), and by doing background checks on employees.
Money Laundering	The illegal process of "clearing" large sums of money through criminal activity (such as people or drug trafficking, or terrorist funding) by making it appear that such money came from a legitimate source.

Types of Financial Fraud Risk That Can Affect an Organization Cont.	
Bribery (also known as "payoffs" or "kickbacks")	An illegal payment made to an employee to give preferential treatment or other inappropriate services in return. The bribe could be a gift, money, credit, or anything else of value. Bribes also interfere with the employee's ability to make an unbiased decision and can severely harm an organization's reputation.
Extortion	The use of violence, threats or intimidation to gain money from an employee or an organization. Blackmail is a form of extortion, and ransomware (a type of malware that threatens to steal or sell personal data if a ransom is not paid) is a growing form of it.
Counterfeiting	This involves the manufacturing and distribution of goods under an organization's brand name, without their permission. Counterfeit goods are often made at a lower quality than the original so that they can be sold cheaply. It can also be responsible for child or slave labor, and organized crime. Counterfeiting can have a severe impact on the legitimate organization's reputation, as well as its sales and profits.

Template: Profit and Loss Account (Income Statement)

12 Months Ending	**Year Ending __________ ($000)**	**Year Ending __________ ($000)**
Turnover		
Total turnover		
Direct Costs		
Total direct costs		
Gross Profit *(Turnover - Direct Costs)*		
Gross Profit Margin *(Profit as a % of Turnover)*		
Adjusted Overhead Costs		
Wages		
Total		
Profit Before Tax *(Gross Profit - Overheads)*		
Tax		
Profit After Tax *(Profit Before Tax - Tax)*		
EBITDA *(Profit - Adjusted Overheads excluding Depreciation, Amortization and Interest)*		
EBITDA Margin *(EBITDA as a % of Turnover)*		

Template: Balance Sheet

Assets	($000)	Equities	($000)
Fixed Assets		Owners' equity	
Tangible		Profit for year	
Intangible			
Total Fixed Assets			
Current Assets			
Cash at bank			
Stock			
Debtors			
Total Current Assets			
Current Liabilities			
Owed to suppliers			
Payroll taxes due			
Total current liabilities			
Long-Term Liabilities			
Bank loans			
Net Assets *(Total Fixed Assets + Total Current Assets - (Current Liabilities + Creditors Due After One Year))*			
Working Capital *(Current Assets - Current Liabilities)*		**Total Equity**	

Template: Cash Flow Statement

	Year Ending: ____________ (£000)	Year Ending: ____________ (£000)
Cash Flow from Operating Activities		
Profit before tax		
Net interest		
Operating Profit		
Depreciation and amortization		
Working capital investments		
Net cash generated from operating activities		
Investing Cash Flow		
Investments in property and equipment		
Total cash from investing		
Financing Cash Flow		
Issuance (repayment) of debt		
Issuance (repayment) of equity		
Total cash from financing		
Net Increase/(Decrease) in Cash *(Total Operating Cash - Total Cash From Investing - Total Cash From Financing)*		
Opening Cash Balance		
Closing Cash Balance		