AQA Realising potential

Unit 1 Financial planning and analysis amplification

Please note: the amplification contained in the 3rd column below is intended to give greater illustrative detail to each of the assessment outcome themes. The 3rd column content is **indicative** in nature and intended to give tutors greater guidance in relation to delivery planning. The 3rd column content is **not exhaustive**, and where 'egs' are used to illustrate the sense of a particular theme, you should anticipate other relevant examples and/or other relevant areas of content.

Unit Content:

Assessment Outcome 1: Investigate why business enterprises plan their finances		
Topic	**Content**	**Amplification**
Business planning	• Planning an enterprise: ○ start-up ○ running costs ○ profit	Candidates will need to be able to identify and explain start-up and running costs in various situations. Examples could include: • "Which of the following is a start-up/running cost?" • "What is the value of start-up/running costs?" from a list of costs • "Why is it important to identify start-up/running costs?" in given situations. For example, the cost of launching a new product, impact on cash-flow. Profit and profitability are looked at in more depth in AO2-AO4. Here profit is as an aim to be achieved. But survival and break-even would be objectives when starting a business.

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Planning to meet financial objectives:

making a return for the owners of the enterprise
setting profit targets
ensuring sufficient cash resources
long term financing

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This section can be seen as an expansion of the need for planning in the previous section:

What the owners might consider as a reasonable return on their investment and setting profit targets for this e.g. as:

a start-up/established business.
an owner/manager
external investor.

The different positions in a business life cycle and the need for cash resources e.g.:

start-up
credit payment and debt collection.

The implications of business failure.
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Providing information to key stakeholders to enable them to make decisions about the viability of an enterprise or expansion:

owners/shareholders
potential funders
suppliers

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For example:

Owners/shareholders/potential funders:

profitability to assess their return on investment
financial stability - is the enterprise able to pay its short and long term debts?

Suppliers will look for evidence to:

judge if the enterprise is able to pay for goods or services bought using trade credit
to determine credit payment periods.

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<td>Legal structures of business</td>
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Financial implications of using different legal forms of business:

sole traders
partnerships and limited liability partnerships (LLP)
private limited companies

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This section will be familiar from most business specifications. The financial implications will relate to the liability of the owners of the enterprise and the amounts of finance required.

Learners should understand that some legal forms are
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<td>public limited liabilities
community interest companies
co-operatives</td>
<td>more appropriate that others in particular circumstances. For example:
There will be reasons for example why not all business enterprises will require the protection of limited liability.
Not for profit organisations might favour different legal forms than for profit making organisations.</td>
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<td>Financing the enterprise</td>
<td>Operating and expanding the enterprise:
financing business start-up
meeting running costs
cash-flow
internal sources of finance
external sources of finance</td>
<td>Internal/external sources of finance can be used to finance business costs and cash flow. Consider the sources of finance that are appropriate/available for different types of business and the advantages /disadvantages of each source of finance.

Internal:
Owners funds
Retained profits
Sale of assets
External:
Sale of shares
Loans
Leasing
Introduction of a new partner
Government grants
Donations.</td>
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Assessment Outcome 2: Investigate the key elements of financial planning that managers and entrepreneurs must understand		
Topic	**Content**	**Amplification**
Costs and revenue	• Total costs: ○ fixed costs ○ variable costs ○ semi-variable costs	Identification and simple calculation questions for fixed and variable costs could be asked. Identify which costs could be semi-variable. Semi-variable costs are difficult to include in break-even calculations. This could be a limitation of break-even analysis.
	• Total revenue (price x quantity) • Distinction between revenue and capital expenditure	Total revenue could be a calculation question or part of a break-even calculation. There would be the opportunity to explore the price volume relationship here. This also could be part of "what if" scenarios. The distinction between revenue and capital expenditure could be an identification/categorisation question. The categorisation also helps in the understanding of income statements and statements of financial position.
Making a profit or surplus	• Profit/surplus calculations: ○ profit/loss = total revenue – total cost ○ surplus/deficit = income - expenditure	This can be the basis of calculation questions. Which calculation/definition is needed; for example a not for profit organisation would report a surplus rather than a profit.
Break-even	• Break-even: ○ how break-even is calculated ○ contribution ○ uses of break-even	Calculations can be required for break-even and contribution by implication. How break-even/contribution can be used to solve

		simple acceptance of special contract situations, such as, should work in addition to normal activity at a lower price be accepted.
Cash-flow	• Meaning of cash-flow: ○ meeting day to day financial obligations ○ timing of receipts and payments	Students will not be required to produce a cash-flow forecast in the examination. Nor will fill the gap style questions be set purely on cash-flow forecasts. A possible partial exception would be if variance calculations are applied to cash-flow forecasts (see AO3). Buying and selling using trade credit as well as leasing etc have an impact on the timing of receipts and payments. This is likely to be part of a cash-flow forecast that students may be required to interpret in an examination.
	• Differences between profit and cash	One of the most common examination misconceptions by students in examination answers is to confuse cash and profit. The cash-flow forecast does not show profit. Students need to be clear how each may influence decision-making.

Assessment Outcome 3: Consider how managers and entrepreneurs monitor the financial performance of an enterprise		
Topic	**Content**	**Amplification**
Budgets	• Interpreting budgets: ○ income and expenditure ○ cash-flow ○ what if analysis	A budget could be any plan or forecast and this can be compared with actual figures. Therefore a budget could be for income and expenditure, cash-flow forecasts or forecasted income statements or statements of financial position.

		Candidates will not be required to prepare budgets from scratch but will be required to interpret what the budget shows. Candidates will not be required to complete budgets; for example, filling missing figures in a cash-flow statement, however completing variances could be required (see below). What-if analysis can include how budgets may be affected by changes such as timings of receipts, delay in payments etc.

	• Value of variance analysis to evaluate success
	    ○ calculating adverse and favourable variances
	    ○ interpreting variances for decision making
		Variance analysis is a monitoring tool by comparing actual performance with forecast performance. Variance analysis can be used on any budget/forecast (see budgets above).
		
		Examination questions can involve calculating variance by placing forecasted budgeted figure side by side with the actual figure incurred, and identifying if variances are favourable or adverse.
		
		Questions can then be set using the variances calculated or variance information provided to interpret the difference.
		
		Questions can be set on the value of variance analysis on decision making.

Using break-even	• Value and limitations of break-even analysis:
	    ○ setting targets
	    ○ what if analysis
	
	• Contribution analysis:
		Questions can include the value/strengths of break-even analysis including:
		• Helps to set targets
		• Gives an idea of viability/risk
		• Demonstrates the importance of controlling

		costs. • Indication of a margin of safety Questions could also consider the limitations of break-even analysis, for example: • It only provides possible profits and losses, no sales have actually been made • In practice fixed costs are stepped, they eventually rise with increased output • variable costs do not always stay the same • In practice businesses make/trade in more than one product.
Interpreting financial information	• Income statements (profit and loss accounts): ○ gross profit ○ operating profit	For the examination the emphasis here is on interpretation. Candidates will not be required to prepare an income statement. Candidates will be expected to be aware of the content and structure of this document including that sales revenue - cost of sales = gross profit and the gross profit - expenses = operating/net profit. Candidates need to be aware that sufficient profits will be required to pay off loans etc.
	• Statements of financial position (balance sheet): ○ assets ○ liabilities ○ working capital ○ equity	For the examination the emphasis here is on interpretation. Candidates will not be required to prepare a statement of financial position. Candidates will be expected to be aware of the content and structure of this document including the different types of asset non-current/current assets, Equity, non-current/current liabilities.

		Assets can be used as security for a loan. Current assets are part of liquidity. Liabilities need to be paid. Current liabilities are part of liquidity. Equity and non-current liabilities can indicate gearing/solvency. Working capital (net current assets) is defined as current assets-current liabilities and is an indication of liquidity.

Assessment Outcome 4: Assess information to enable stakeholders to make decisions about the financial performance of an enterprise

Topic	**Content**	**Amplification**
Interpreting financial ratios	• Profitability ○ gross profit margin ○ operating profit ○ ROCE • Solvency ○ current ratio ○ acid-test ratio ○ gearing • Activity ○ Inventory (stock) turnover ○ Trade receivables (debt) collection period ○ Trade payables (creditor) payment period	Candidates will not be asked to calculate ratios but should understand the components of ratios. They should also understand the forms in which different rations are expressed (e.g. as a percentage, to one, times and days) and able to interpret results of ratio analysis. The content has been arranged into three headings profitability, liquidity/solvency and activity to provide structure to analysis. Not all ratios will necessarily be provided in every question.

	○ Asset turnover	
	• The strengths and limitations of financial information for decision making	Financial information includes: • Cash-flow forecasts • Actual and forecast income statements and statements of financial position • Ratios.
Market information	• Published accounts of competitors • Market trends • Market and industry research	Market trends and market and industry research includes information such as market size, market growth and competition within the market. Candidates would not be required to name sources of market information but do need to be aware that these resources exist.
Stakeholder perspectives	• Information needed to take decisions by: • owners • Managers • Potential investors • Suppliers	Candidates would need to know why various groups need financial and market information, for example: • Owners and potential investors would be interested in the value of their investments and associated risk. • Managers need information to monitor the business. • Suppliers that goods/services they provide will be paid for.