

# Financial information in decision making

## Introduction

CIMA is the Chartered Institute of Management Accountants. It supports over 164,000 members and students in 161 countries. CIMA works with some of the world's leading businesses and provides a professional qualification in management accounting.

Management accounting plays a vital role in a business. Management accountants look forward and use financial information to help a business make key decisions about its future. This demonstrates the value of the qualification in supporting business.

CIMA's qualification is the leading management accounting qualification in the world. CIMA-qualified members work in both the **public sector** and **private sector**, in commercial and **not-for-profit organisations**. CIMA updates its qualifications regularly to take account of the changing needs of employers, students, managers and businesses. CIMA **stakeholders** include its own students, qualified members and major employers. It supports students and members through all stages of their careers, with a focus on lifelong learning.

CIMA works to maintain the highest standards that businesses want. Its training provides CIMA members with the necessary skills to manage some of the world's most successful businesses. CIMA members may lead the finance function in any organisation, or work in roles outside finance. They have roles in top management leading companies like Norwich Union, Cadbury Schweppes and Nintendo.

## Financial accounting

Financial accounting refers to the figures, balances and accounts that a business must produce to demonstrate how the business is performing. In a small business, such as a **sole trader** or partnership, these accounts may be quite simple. However, they still need to be accurate. This is so that the business owner/s and the tax authorities have clear information about the costs and profits of the business. Once a business becomes a **limited company**, there is a legal requirement to publish certain figures. These include:

- balance sheets, showing a snapshot of what a business owns and owes at a specific point in time
- **profit and loss account**, showing the profit or loss the company has made in a specific period of time
- in **public limited companies**, the cashflow statement, showing where cash has come from and how it has been spent over the past year.

Financial accounts relate to the *past* performance of the business. They give an important baseline of financial information for managers. However, this information is also publicly available to anyone else, including competitors, suppliers, government and investors. Managers need to be able to see how the business has performed in the past to enable them to look to the future.

### CURRICULUM TOPICS

- Financial accounting
- Management accounting
- Ratio analysis
- Business strategy



### GLOSSARY

**Public sector:** businesses or organisations owned or operated by public bodies, such as local and national government.

**Private sector:** businesses owned by private individuals such as partners or shareholders.

**Not-for-profit organisations:** organisations such as charities, who do not aim to make a profit.

**Stakeholders:** Individual or group with an interest in the decisions made by an organisation.

**Sole trader:** the business and its owner are one - and the same. The individual is liable for the business and debts.

**Limited company:** a company whose owners enjoy limited liability for the company's debts and losses.

**Profit and loss account:** this shows a firm's income and costs over a given period of time (usually a year).

**Public limited companies:** companies with shares quoted (priced, bought and sold) on a stock exchange.



Diageo



Nintendo UK

**GLOSSARY**

**Strategic:** long-term business plan of an organisation.

**Efficiency or activity ratios:** measures of how efficiently a business is using its resources. Liquidity ratios are a subset of these. They measure how easily the business can pay its debts.

**Liquidity:** describes the state of having assets in the form of cash or other assets that are readily convertible to cash.

**Gearing:** a measure of how dependent a company is on long-term finance.

**Profitability or performance ratios:** measures of the amount of profit being made compared to the inputs being used.

**Cashflow forecasts:** prediction of likely future flows of costs and revenues.

**Budgets:** financial plans for the future that show where costs and revenues will come from.

**Variations:** the difference between what was forecast to happen (say, in a budget) and what actually happened.

**Investment appraisal:** used to decide whether a particular investment is or is not worthwhile by looking at the likely returns over a particular period.

The main tasks for financial accountants are:

- keeping accurate records such as ledgers, books and accounts
- ensuring invoices are raised and bills paid
- checking and monitoring spending and balances.

## Management accounting

Management accountants look ahead - they focus on forecasting and decision-making. They use information to advise on how the business can move forward, for example, should a company buy another, should it invest in new equipment. Management accounting involves using the internal financial information available to managers, as well as that information which companies must publish by law. This contributes to forward planning, reviewing and analysing the performance of the business.

Management accounting is fundamental in strategic planning. When a business is looking to make a strategic decision, for example, whether to develop a new product line, acquire another business or expand into other countries, the CIMA trained management accountant can provide advice. They can use a number of tools to assist decision-making. These include ratio analysis, budgets and forecasts (such as cash flow and variances).

A ratio is one variable measured in terms of another, for example, how many girls are in a class compared to the number of boys. Ratio analysis is one tool in the **strategic** decision making process. Management accountants use ratios along with other internal business data and publicly available information to assess aspects of a company's performance.

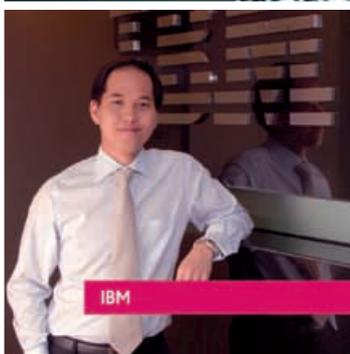
The main ratios used in management accounting are:

- **efficiency or activity ratios**, including **liquidity** - these show whether the business is able to pay its debts. They look at whether the assets of the company (its buildings, land equipment) could repay any debts.
- **gearing** - shows the long-term financial position of the business. It can show balance of funding in a business i.e. how much money is from loans (on which it needs to pay interest) and how much is from shareholder funds (on which it needs to pay a dividend to shareholders). More money from loans carries more cost and therefore more risk.
- **profitability or performance ratios** - show how well a business is doing. They relate to the business objectives, which might be to make profit or obtain a return on investment, or collect its debts quickly.

It is important that management accountants look at all the relevant ratios when making a decision.

Management accountants need to be able to produce accurate analysis, correct forecasts and a detached and professional overview to a company's performance. These contribute to the future success of a business. Other tools available to a management accountant include:

- **cashflow forecasts** which look at likely future flows of costs and revenues. The business uses these to plan expenditure and to see where it might need to borrow.
- **budgets**, which are financial plans for the future. They help the business to see where it will incur costs and where revenues will come from. They are particularly important in helping to co-ordinate the different parts or activities of a business.
- **variances** which show the difference between what was forecast to happen (say, in a budget) and what actually happened. The reasons for these differences can then be analysed to show why the variance occurred. Management accountants can then see how the business can build on positive variances or avoid negative ones in future.
- **investment appraisal** helps to decide whether a particular investment is worthwhile or not. It looks at the costs of investing, for example in a new factory or processes and at the likely financial returns.



## Business Strategy

Strategic decisions are major decisions taken at the highest level of management in an organisation by the Chief Executive, Directors or Board members. They determine the direction of the business over future months and years. They have greater and wider-reaching consequences than the **tactical decisions** (such as changes to factory layout or processes) or **operational decisions**, such as increasing the number of staff on a product line, made by junior or middle managers. These affect the day-to-day running of the business. Business strategies enable a business to grow and to strengthen its position in the market. If a business wants to grow it can do this by:

- organic growth - developing the business from within by
  - growing more or different products within its own market
  - developing new markets. This could be through various routes such as new products, and new geographical markets such as overseas or new distribution channels.
- Inorganic growth - joining with other businesses through
  - take-over
  - merger.

Management accountants help a business make strategic decisions by:

- identifying and collecting key information
- measuring and interpreting information
- analysing information
- communicating findings
- joining with other managers to plan changes
- monitoring, measuring and controlling progress.

The tools of management accounting help support the policy of a business. Strategic, long-term decisions involve the future direction of the business. If the forecasts and decisions are right, the business will grow and succeed. But if a business makes poor decisions, it may fail. For example, a business may decide to invest in new technology to improve the efficiency of production. If it has analysed the benefits properly, the investment will lead to growth and more profit. However, if the business has not evaluated all factors and the technology is untested, it may not give a **return on investment**.

## CIMA strategists in practice

CIMA qualified management accountants can reach high level and well paid jobs in many well-known companies. They are responsible for key areas of the company, helping in strategic decision-making.

Matthew Parker is the Retail Finance Manager at Topshop, one of the seven key brands of the Arcadia Group. Arcadia is a young and very vibrant company. People are passionate about what they do and that comes through in their jobs. For Matthew it provided a passport to a job with variety and challenge:

*'With CIMA you're getting involved in the strategic management within the business... you have the chance to influence and suggest ideas to key decision makers. A CIMA qualification is almost a commercial toolkit that gives you a way of breaking information down and looking at investment decisions to make sure what is the most profitable. I know it's a cliché, but no two days are the same. I'll sit down with the regional controllers and area managers at the beginning of a financial half and we'll discuss the plan and then that strategy gets passed on to the decision making body. I just don't think in many other accountancy roles you get such a level of variety and input, which makes it fantastic.'*



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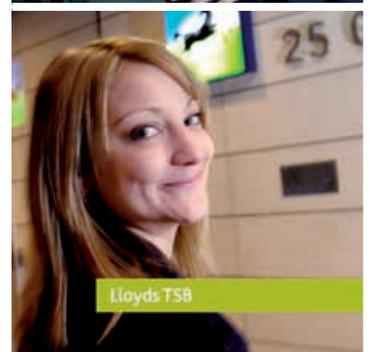
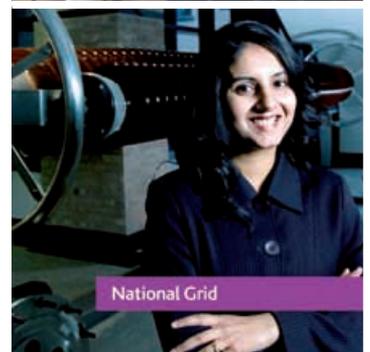
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### GLOSSARY

**Tactical decisions:** made by senior managers and may have far-reaching effects.

**Operational decisions:** involve the day-to-day running of the business.

**Return on investment:** the return on the funds invested in the business.



Gajen Ganandran is a financial analyst with Aviva, which owns Norwich Union. Aviva is the world's fifth largest insurance group and the biggest in the UK. Gajen has a degree in computing but realised early on in his career the importance of understanding financial data, so he undertook a CIMA qualification. Since then he has travelled to New York and the USA and is hoping to take up an opportunity with Aviva to work overseas, ideally in Singapore.

Tom Pearce is Finance Director of Nintendo UK the global leader in interactive entertainment. Tom did his 'A' levels in business studies and accountancy. He then took a degree in accounting and finance. From his first job onwards, Tom set about improving his qualifications through CIMA. Tom works in an office full of the latest Nintendo gadgets and games, including the successful Nintendo Wii. From his experience of working within a business, Tom decided that he did not want to be a 'traditional' accountant.

*'I wanted to apply my skills to a commercial setting. I chose CIMA because it was recognised globally and the most geared to the business environment.'*

In the same year that Tom qualified with CIMA, he was offered the role at Nintendo, starting the UK side of the Japanese company from scratch. In a short time he became Financial Director, responsible for decisions affecting sales of over £600 million.

Sharon Bachu found CIMA's support invaluable in her job at Cadbury Schweppes. She is a CIMA Training Co-ordinator and one of the key players in the relationship between Cadbury Schweppes and CIMA. Cadbury Schweppes is a CIMA Training Quality Partner. Sharon's job includes the evaluation of new product ranges, deciding on promotions and working on seasonal ranges for Easter and Christmas. She even decides which products should go into a selection box.

*'I'm loving every minute working with current brands and developing insight for the future.'*

## Conclusion

Financial accountants maintain a business' balances and accounts. They keep the business' records legal and financially stable.

Management accountants focus on forecasting. They have an exciting and forward-looking strategic role in many different types of organisations. They use various tools, such as ratio analysis and investment appraisal, to identify, measure and analyse the financial performance of a company.

Many CIMA-trained management accountants are at the heart of top businesses in a wide variety of roles, including financial analyst or finance director. They contribute to decision-making across the organisation. The analysis they provide is vital in taking a business forward.

## Questions

1. Explain the key differences between financial accounting and management accounting.
2. Outline the different types of decisions made in a business. Which do you think is most important and why?
3. Explain what is meant by a 'ratio'. Explain the purpose of the main ratios used by businesses.
4. Evaluate the other tools used by management accountants. Which do you think is most important and why?



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