

DECEMBER 2011 – STUDY GUIDE
FOUNDATIONS IN ACCOUNTANCY

Paper FFM
Foundations in Financial Management

Introduction

This booklet contains the Study Guide for Paper FFM: Foundations in Financial Management.

The Syllabus outlines the content of the paper and how that content is examined. The Study Sessions take the syllabus and expand it into teaching or study sessions of similar length. These sessions indicate what the examiner expects of candidates for each part of the syllabus, and therefore gives you guidance in the skills you are expected to demonstrate in the examinations. The time to complete each session will vary according to your individual capabilities and the time you have available to study. Tuition providers offering face-to-face tuition are recommended to design courses with a minimum of two hours tuition per study session. However, repeated coverage of the material is vital to ensure your understanding and recall of the subject. Be sure to practice past examination questions to consolidate your knowledge and read your *student accountant* magazine regularly.

If you have any queries concerning the study guide, please direct them to:

Qualifications Department
ACCA 29 Lincoln's Inn Fields London WC2A 3EE United Kingdom
tel: +44 (0)20 7059 5833 fax: +44 (0)20 7059 5968
e-mail: info@accaglobal.com

Additional information can be accessed on the ACCA website at:
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ABOUT ACCA

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AIMS

To develop knowledge and understanding of the way organisations finance their operations, plan and control cash flows, optimise their use of working capital and allocate resources to capital expenditure projects.

OBJECTIVES

On completion of this paper, candidates should be able to:

- describe the cash flow cycle
- describe sources of short, medium and long-term finance
- prepare cash budgets and cash flow forecasts
- explain the principles of effective working capital management
- calculate working capital requirements
- describe credit management methods and procedures
- describe cash management methods and procedures
- make short-term decisions to enhance business performance
- evaluate capital expenditure proposals.

POSITION OF THE PAPER IN THE OVERALL SYLLABUS

Paper FFM will build on the knowledge of the main receipts and payments that an organisation has and the methods of recording these receipts and payments, developed in the Introductory and Intermediate Level papers.

There are also links with other Advanced Level papers, particularly:

- budgets, forecasts, time series analysis and index numbers in Paper FMA, *Management Accounting,*
- interpretation of limited company financial statements in Paper FFA, *Financial Accounting.*

However, there will not be a presumption of any prior knowledge from the other Advanced Level papers.

SYLLABUS CONTENT

1 Cash receipts and payments

(a) Types of receipts and payments

(b) Cash budgets and forecasts

(i) form and structure of cash budgets and forecasts

(ii) modelling of sensitivity of elements to change (e.g. price, wage rate changes)

(iii) preparation of cash budgets, including adjustments for timing

(iv) preparation of simple cleared funds forecasts

(v) budgets and forecasts as mechanisms of monitoring and control

(c) Accounting for cash

(i) relationship of cash flow accounting to accruals accounting

(ii) profits and cash flow

(d) Cash management

(i) role of the treasury function

(ii) cash handling procedures

2 Cash balances

(a) Surplus funds

(i) types of investments

(ii) investment risk and exposure

(iii) short and long-term investment management

(b) Liquidity management

(i) optimum liquidity levels

(ii) liquidity ratios and the working capital cycle

(iii) comparison with cash budgets and forecasts

(iv) legal relationship between bank and customer

(v) statutory and other regulations relating to cash management of public sector organisations

3 Working capital management

(a) Importance of working capital management

(b) Working capital cycle

(c) Inventory control

(i) inventory ordering and storing policies

(ii) economic order quantity

(iii) impact of lean manufacturing and just-in-time

(d) Control of accounts payable

(i) monitoring of accounts payable

(ii) payment procedures

(iii) risks of excess credit

4 Credit granting

(a) Information sources

(i) internal sources of credit information

(ii) external sources of credit information
(iii) interpretation of credit information

(b) Credit terms
(i) credit policies
(ii) individual customers

(c) Accounts receivable records
(i) content of records
(ii) data protection issues

(d) Legal issues
(i) basic contract
(ii) terms and conditions of contracts relating to the granting of credit

5 Debt collection

(a) Monitoring of accounts receivables
(i) internal sources
(ii) external sources

(b) Collection of accounts receivable
(i) methods of collection
(ii) factoring arrangements
(iii) invoice discounting
(iv) accounts receivable insurance

(c) Dealing with slow-paying credit-customers
(i) identification of potential problems
(ii) methods of contacting credit customers
(iii) legal procedures for recovery of debts and breach of contract
(iv) bankruptcy and insolvency of credit customers

6 Sources of finance

(a) Overview of the economic environment
(i) banking system and money market in the UK
(ii) relationship between financial institutions
(iii) impact of government and central bank monetary policy

(b) Sources of finance

Discussion of the relative risks and costs of various types of finance and their suitability to different circumstances and organisations (large and small, listed and unlisted), including:

(i) balance of short / medium / long-term finance
(ii) the nature and importance of internally generated funds
(iii) capital markets
(iv) bank finance (short, medium and long-term)
(v) hire purchase, finance and operating leases
(vi) trade credit
(vii) government sources
(viii) problems of small and medium-sized enterprise financing
(ix) venture capital and other financial sources particularly suited to the small and medium sized enterprises

(c) Calculations for relative gearing and EPS under different financial structures

7 Short-term decisions

Application of the following principles:

(a) Cost behaviour and cost volume profit analysis
(b) Break-even charts and profit-volume charts
(c) Make or buy decisions
(d) Opportunity costs and relevant costs

8 Capital investments

(a) Nature of capital investment budgeting
(b) Capital investment procedures (authorisation and monitoring)
(c) Non-discounted cash flow methods of project appraisal
(i) accounting rate of return
(ii) payback

(d) Discounted cash flow techniques
(i) time value of money
(ii) compounding and discounting
(iii) relevant cash flows
(iv) net present value
(v) internal rate of return
(vi) discounted payback

EXCLUDED TOPICS

The following topics are specifically excluded from Paper FFM:

- detailed knowledge of bankruptcy and insolvency legislation
- double entry for bad and doubtful debts
- NPV calculations for tax, inflation and working capital.

KEY AREAS OF THE SYLLABUS

The key topic areas are:

- sources of finance
- cash budgets
- working capital management
- credit management
- short-term decisions
- capital investment appraisal.

APPROACH TO EXAMINING THE SYLLABUS

The examination is a three-hour paper combining multiple choice questions and written questions as follows:

		No. of marks
Section A:	10 multiple-choice questions:	20
Section B:	4 written questions (20 marks each):	80
Total		100

LEARNING MATERIALS

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ACCA's Content Provider Directory can be found here –http://www.accaglobal.com/learningproviders/alpc/content_provider_directory/search/.

Relevant articles will also be published in Student Accountant.

STUDY SESSIONS

1 The nature of cash and cash flows

(a) Define cash, cash flow and funds

(b) Explain the importance of cash flow management and its impact on liquidity and company survival

2 The cash flow cycle and accounting for cash

(a) Outline the various sources and applications of finance
  (i) regular revenue receipts and payments
  (ii) capital receipts and payments
  (iii) drawings or dividends and disbursements
  (iv) exceptional receipts and payments

(b) Distinguish between the cash flow patterns of different types of organisations

(c) Explain the importance of cash flow for sustainable growth of such organisations

(d) Define "cash accounting" and "accruals accounting"

(e) Explain the difference between cash accounting and accruals accounting

(f) Reconcile cash flow to profit

3 Overview of financial markets

(a) Explain the structure of a banking system

(b) Explain the role and functions of various types of banks (including central and commercial banks)

(c) Identify the major financial intermediaries

(d) Outline the general roles of financial intermediaries

(e) Outline the key benefits of financial intermediation

(f) Outline the relationships between financial institutions

(g) Explain the basic nature of a money market

4 Cash in the economy

(a) Define what is meant by "money supply" in an economic context

(b) Outline how money supply may be controlled in an economy

(c) Outline the basic relationship between the demand for money and interest rates

(d) Describe how the application of different monetary policies can affect the economy (for example, effect on inflation)

5 Types of finance and short-term finance

(a) Discuss the relative merits and limitations of short/medium/long term finance

(b) Outline the key factors that should be considered in deciding the mix of short/medium/long term finance in an organisation

(c) Discuss the nature and importance of internally generated funds

(d) Outline the major sources of government funds e.g. grants, regional and national schemes

(e) Discuss situations where it may be appropriate to raise short-term finance

(f) Outline the different forms of bank loans and overdrafts, their terms and conditions

(g) Explain the legal relationship between bank and customer

(h) Explain the nature of trade credit and its use as a short-term source of finance

(i) Evaluate the risks associated with increasing the amount of short-term finance in an organisation

6 Medium-term finance

(a) Discuss situations where it may be appropriate to raise medium-term finance

(b) Describe the main features of hire purchase, finance leases and operating leases

(c) Compare and contrast the main features of hire purchase, finance leases and operating leases
(NB – lease or buy decisions are not examinable)

7 Long-term finance 1

(a) Discuss situations where it may be appropriate to raise long-term finance

(b) Outline the key factors to be considered when deciding on an appropriate source of long term finance (debt or equity)

(c) Calculate relative gearing and earnings per share under different financial structures

8 Long-term finance 2

(a) Describe the way in which a stock market (both main and second tier) operates

(b) Discuss ways in which a company may obtain a stock market listing

(c) Explain the advantages and disadvantages of having a stock market listing

(d) Outline the features of different types of securities (equity, preference, debt, convertible debt, warrants)

9 Sources of finance for small and medium sized enterprises 1

(a) Outline the requirements for finance of SMEs (purpose, how much, how long)

(b) Describe the nature of the financing problem for SMEs in terms of the funding gap, maturity gap and inadequate security

(c) Discuss the contribution of lack of information in SMEs to help explain the problems of SME financing

(d) Describe and discuss the response of government agencies and financial institutions to the SME financing problem

10 Sources of finance for small and medium sized enterprises 2

(a) Describe the main features of venture capital

(b) Describe the key areas of concern to venture capitalists when evaluating an application for funding

(c) Explain how the use of such measures as credit suppliers, hire purchase, factoring and second tier listing can help to ease the financial problems of SMEs

(d) Outline appropriate sources of finance for SMEs

11 Inflation

(a) Define inflation

(b) Explain the nature of inflation

(c) Explain briefly the interaction between inflation and interest rates

(d) Evaluate and demonstrate the impact of inflation on cash flow and profits (note calculations are required)

(e) Explain how organisations may protect themselves against the effects of inflation

(f) Discuss the possible consequences of inflation in an economy

(g) Discuss the effects of inflation on organisations in general

12 Investing surplus funds 1

(a) Define what is meant by "surplus funds"

(b) Explain how surplus funds may arise

(c) Discuss the objectives to be considered in the investment of surplus funds

(d) Define the risk-return trade-off

(e) Outline what is meant by risk of default, systematic risk and unsystematic risk

(f) Outline how the Baumol cash management model works (note – calculations are not required)

(g) Discuss the limitations of the Baumol cash management model

(h) Suggest appropriate liquidity levels for a range of different organisations

13 Investing surplus funds 2

(a) Explain the purpose and main features of:

(i) bank deposits

(ii) certificates of deposit

(iii) government stocks

(iv) local authority short term loans

(v) bills of exchange

(b) Explain the purpose and main features of:

(i) debentures

(ii) unsecured loan stocks

(iii) convertibles

(iv) corporate preference shares (cumulative, participating, convertible, redeemable)

(v) permanent interest bearing securities

14 Review of sessions 1 – 13

15 Cash management

(a) Outline the basic treasury functions
(b) Discuss the advantages and disadvantages of a centralised treasury function
(c) Discuss the advantages and disadvantages of centralised cash control
(d) Describe cash handling procedures
(e) Outline the issues to be considered when attempting to hold optimal cash balances
(f) Outline the statutory and the other regulations relating to the management of cash balances in public sector organisations.

16 & 17 Cash Budgets

(a) Explain the objectives of a cash budget
(b) Prepare a cash budget, including adjustments for timing of receipts and payments
(c) Discuss how cash budgets can be used as a mechanism for monitoring and control
(d) Carry out simple sensitivity analysis on a cash budget or forecast
(e) Prepare a simple cleared funds forecast

18 Decision-making - short-term decisions

(a) Describe the relationship between fixed and variable costs and the time horizon under consideration
(b) Explain the advantages and limitations of different costing methods when used in decision-making (marginal and absorption costing)
(c) Describe the concept of relevant costs and its importance for decision-making
(d) Outline the advantages and limitations of using short-term decisions
(e) Describe the qualitative factors that may influence short-term decisions
(f) Prepare reports making recommendations for management action in connection with short-term decisions

19 Cost/volume/profit (CVP) relationships

(a) Calculate and explain the break-even point in single product situations
(b) Analyse the effect on the break-even point of changes in sales price and costs
(c) Prepare and explain the break-even charts and profit volume charts
(d) Describe the advantages and limitations of breakeven analysis for management decision-making

(Note: break-even analysis will only be examined in the context of single product situations)

20 Capital budgeting

(a) Discuss the importance of capital investment planning and control
(b) Outline the issues to consider and the steps involved in the preparation of a capital expenditure budget
(c) Define and distinguish between capital and revenue expenditure
(d) Compare and contrast investment in fixed assets and investment in working capital
(e) Describe capital investment procedures (authorisation and monitoring)
(f) Calculate the payback of a project and assess its usefulness as a method of investment appraisal
(g) Calculate the discounted payback of a project and assess its usefulness as a method of investment appraisal
(h) Calculate the accounting rate of return of a project and assess its usefulness as a method of investment appraisal

21 Financing concepts

(a) Explain the differences between simple and compound interest
(b) Calculate future values
(c) Discuss the concept of time value of money
(d) Discuss the concept of discounting
(e) Calculate present values, making use of present value tables to establish discount factors

22 Capital investment decisions 1

(a) Discuss the concept of relevant cash flows for decision making

(b) Identify and evaluate relevant cash flows for individual investment decisions
(c) Explain the concept of net present value and how it can be used for project appraisal
(d) Calculate net present value and interpret the results (Note: NPV calculations will not include adjustments for inflation, tax or working capital)

23 Capital investment decisions 2

(a) Outline the concept of internal rate of return and how it can be used for project appraisal
(b) Calculate internal rate of return and interpret the results
(c) Discuss the relative merits of NPV and IRR, including mutually exclusive projects and multiple yields
(d) Calculate payback, discounted payback and accounting rate of return
(e) Explain the superiority of DCF methods over payback and accounting rate of return

24 Working capital management

(a) Define working capital
(b) Explain why working capital management is important
(c) Explain the relationship between cash flows and the working capital cycle
(d) Demonstrate the calculation of the working capital cycle (also known as the cash operating cycle)
(e) Outline the possible relationships between inventory levels and sales
(f) Define and explain over-trading and over-capitalisation
(g) Identify and calculate over-trading and over-capitalisation financial indicators

25 Inventory control

(a) Discuss the key considerations when developing an inventory ordering and storage policy
(b) Define and explain work in progress
(c) Define economic order quantity (EOQ)
(d) Apply the EOQ model
(e) Discuss the effects of just-in-time on inventory control (Note: Economic Batch Quantities, where all items in a batch do not arrive simultaneously, will not be examined)

26 Accounts payables control

(a) Explain the role of accounts payables in the working capital cycle
(b) Explain the need to monitor accounts payables
(c) Explain accounts payables control operations and the importance of accounts payables management
(d) Describe the various types and form of accounts payables
(e) Describe the various accounts payables payment methods and procedures (for example, direct debit, cheque)
(f) Evaluate and demonstrate the issues involved with early payment and settlement discounts
(g) Identify the risks of taking increased credit and buying under extended credit terms

27 Accounts receivables control 1

(a) Explain the role of accounts receivables in the working capital cycle
(b) Explain the importance of credit management, including the level of trade credit, the role of the credit control function and the activities of the credit control function
(c) Explain the need to establish a credit policy and outline the steps involved, including setting maximum credit amounts and periods and total credit levels
(d) Explain the key categories that should be considered when assessing the credit-worthiness of a customer
(e) Outline the various internal sources of information that may be used in assessing the credit-worthiness of a customer
(f) Outline the various external sources of information that may be used in assessing the credit-worthiness of a customer
(g) Define and explain credit scoring
(h) Identify possible reasons for rejecting an application for credit

28 Accounts receivables control 2

(a) Outline how the financial statements of a customer can be used to assess the credit-worthiness of a customer

(b) Identify and apply the common ratios that may be used to analyse the financial statements of a customer in order to assess their credit-worthiness

(c) Evaluate the usefulness and limitations of ratio analysis in assessing credit-worthiness

29 Accounts receivables control 3

(a) Identify the main contents of accounts receivables records

(b) Outline the main techniques that may be used to assist in the collection of overdue debts

(c) Describe how factoring works and the main types of service provided by factors

(d) Define invoice discounting and outline how this form of factoring works

(e) Calculate the cost of factoring arrangements, invoice discounting and changes in credit policy

30 Collection of debts

(a) Identify the main methods used to identify potential problems with credit customers meeting their payment obligations

31 Legal issues

(a) Explain the key elements of a basic contract (offer, acceptance, etc)

(b) Briefly outline specific terms and conditions that may be included in contracts with credit customers (e.g. length of credit period, amount of interest on late payments, retention of title)

(c) Outline the basic legal procedures for the collection of debts

Revision