Exam FFM

Foundations in Financial Management

Pocket Notes

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Contents

Preface

These Pocket Notes contain everything you need to know for the exam, presented in a unique visual way that makes revision easy and effective.

Written by experienced lecturers and authors, these Pocket Notes break down content into manageable chunks to maximise your concentration.

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Introduction

In this chapter

- Overview of the assessment.
- Keys to success.

Overview of the assessment

	No. of marks
Section A: 10 MCQs	20
Section B: 6 WTQs (10, 15 or 20 marks each)	80
	100

The exam is a two hour paper.

Keys to success

- Ensure you are familiar with the entire syllabus, as this will be examined.
- Practise lots of past examination questions.
- Set out your answers clearly – and don't jump between questions in the examination itself as this may confuse the examiner.

chapter

1

Cash and cash flows

In this chapter

- Cash and cash flows.
- Sources and applications of finance.
- Cash flow and profit.
- Cash and accruals accounting.

Cash and cash flows

Definition

Cash: Paper money and money in bank accounts.

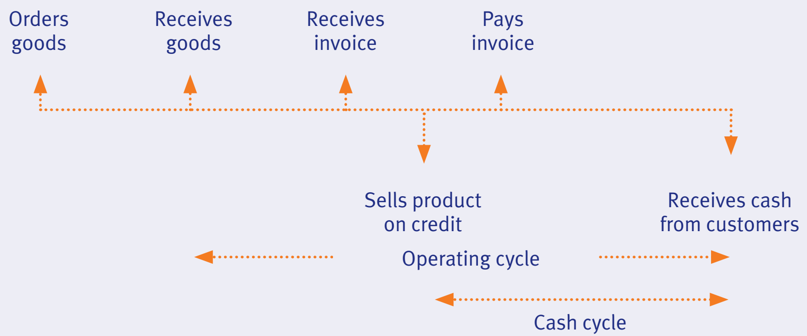
Cash flow: Receipts and payments of cash.

Net cash flow: Difference between cash received and cash paid.

Cash inflows vary depending on business type e.g.:

Supermarket	Regular cash inflow
Hats	Seasonal – spring and summer
Ice cream	Seasonal – summer
College	Irregular – whenever courses start

Cash cycle and operating cycle



Sources and applications of finance

Sources of cash	Uses of cash
Obtaining finance: • Increase in long-term debt • Increase in equity • Increase in current liabilities Selling assets • Decrease in current assets • Decrease in non-current assets	Paying payables or stockholders: • Decrease in long-term debt • Decrease in equity • Decrease in current liabilities Buying assets • Increase in current assets • Increase in non-current assets

Receipts	Payments
Revenue	
• Cash sales • Payments by receivables	• Trade payables (goods and services purchased) • Employees (salaries) • Sundry expenses (petty cash)
Capital	
• Money from shareholders/capital from owners • Non-current asset sales	• Non-current asset purchases
Drawings / dividends	
	• Drawings (sole trader / partnership) • Dividends (limited company)
Exceptional (unplanned)	
• Items not mentioned above	• Items not mentioned above

Cash flow and profit

Key Point

- Profit = excess of income over expenditure in statement of profit or loss.
- For business to survive, cash inflows must exceed cash outflows.
- Cash flow and profits are different.
- Business can make a profit, but still have negative cash flows.

Reasons for differences in cash flows and profits

Business activity	Effect on cash and profit
Purchase of non-current asset	Cash outflow, no effect on profit
Depreciation charge on statement of profit or loss	No effect on cash, profit decreased
Increase in working capital (e.g. inventory purchase)	Cash outflow, no effect on profit
Normal trading	See below

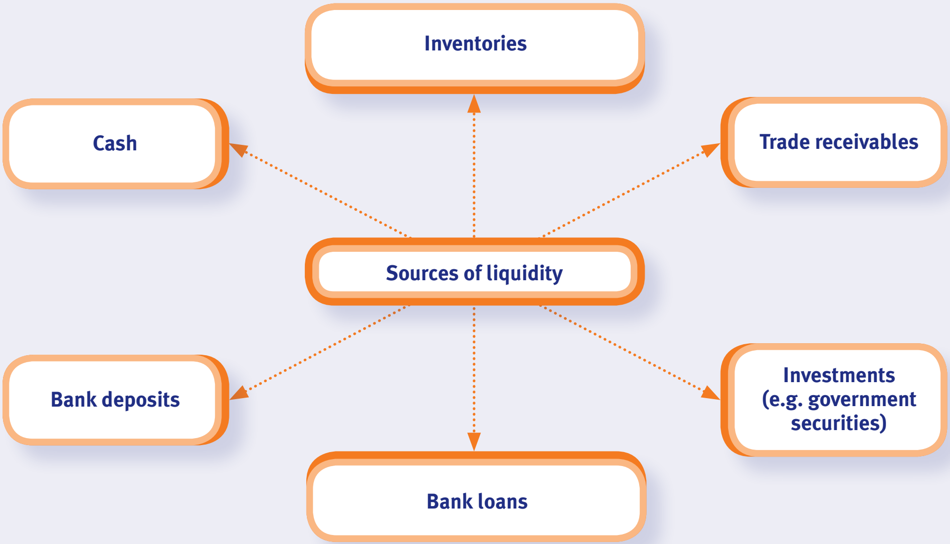
Statement of profit or loss		Cash effect		
	January	January	February	March
	$	$	$	$
Sale	1,000		1,000	
Purchase	(600)			(600)
Gross profit	400			
Wages	(200)	(200)		
Light and heat	(100)		(100)	
Net profit	100			
	Cumulative cash flow	(200)	700	100

From January sales only:

- Sales made in January give profit in January.
- Cash flow in January is negative because employees must be paid; no cash received.
- Cash flow in February is positive because receivables have now been paid.
- Only in March does cash flow = profit when payables finally paid.

Definition

Liquidity: Cash or items that can be converted into cash quickly.



Cash and accruals accounting

Definition

Cash management: Systems and procedures for controlling cash flows and the use of cash in a business.

Cash accounting: Recording income when received and expenditure when it is incurred.

Accruals accounting: Recording income and expenditure when earned.

Different accounting methods give different results.

In previous cash flow example. In January:

- Cash accounting = cash outflow of $200
- Accurals accounting = profit of $100.

Exam focus

Ensure you understand the difference between profit and cash flows and the difference between accruals and cash accounting.