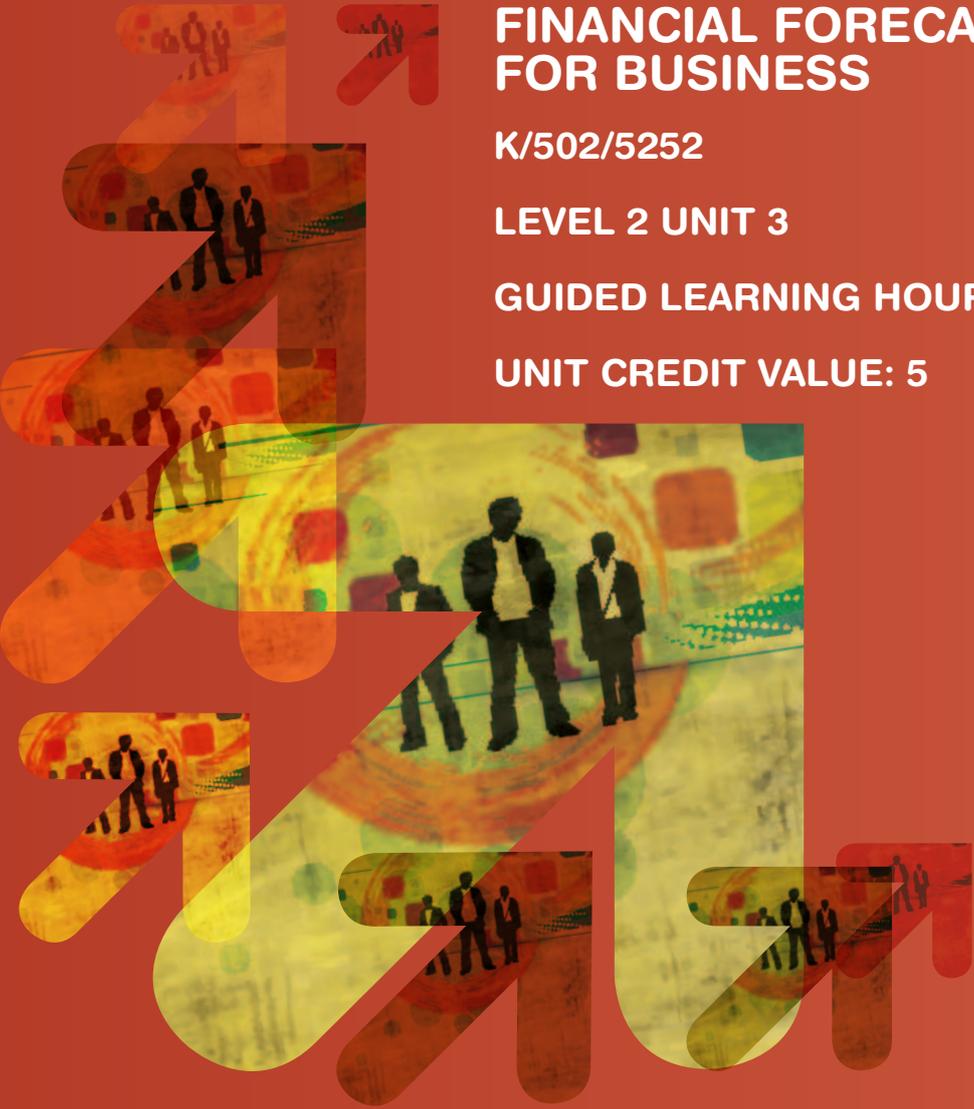




Accredited

# OCR LEVEL 2 CAMBRIDGE TECHNICAL CERTIFICATE/DIPLOMA IN BUSINESS



## FINANCIAL FORECASTING FOR BUSINESS

K/502/5252

LEVEL 2 UNIT 3

GUIDED LEARNING HOURS: 30

UNIT CREDIT VALUE: 5



# FINANCIAL FORECASTING FOR BUSINESS

K/502/5252

LEVEL 2 UNIT 3

## AIM OF THE UNIT

Business is about making money. In simple terms this means getting more money in than the business spends. This unit will give learners the tools they need to be able to classify costs, revenues and profit for a business and, more importantly, to be able to predict what these figures might be.

This unit gives learners the basic financial knowledge needed for all aspect of business and specifically enables learners to use two of the most popular forecasting techniques; break even analysis and cash flow forecasting.

Beyond the simple ability to use these techniques, learners are given the opportunity to analyse the factors which make the techniques more or less useful in the real world and then come to reasoned judgements about how useful the techniques might be for a selected business.

## ASSESSMENT AND GRADING CRITERIA

<b>Learning Outcome (LO)</b>  The learner will:	<b>Pass</b> The assessment criteria are the pass requirements for this unit.  The learner can:	<b>Merit</b> To achieve a merit the evidence must show that, in addition to the pass criteria, the learner is able to:	<b>Distinction</b> To achieve a distinction the evidence must show that, in addition to the pass and merit criteria, the learner is able to:
1 Know about costs, revenue and profit in a business organisation.	P1 Identify the difference between start up and operating costs, variable and fixed costs		
	P2 Identify the different types of revenue		
	P3 Outline the differences between gross and net profit		
2 Be able to prepare a break even analysis	P4 Calculate break even using given data to show the level at which income equals expenditure	M1 Analyse the factors which may affect the break even level of output for a selected business	
	P5 Present the breakeven as an annotated graph showing break even		
3 Be able to create a cash-flow forecast	P6 Prepare an annual cash-flow forecast using monthly data	M2 Analyse the factors which may affect the cash-flow forecast for a selected business	D1 Evaluate the usefulness of cash-flow forecasting for a selected business

## TEACHING CONTENT

The unit content describes what has to be taught to ensure that learners are able to access the highest grade.

Anything which follows an i.e. details what must be taught as part of that area of content.

Anything which follows an e.g. is illustrative, it should be noted that where e.g. is used, learners must know and be able to apply relevant examples to their work though these do not need to be the same ones specified in the unit content.

### Learning Outcome 1 Know about costs, revenue and profit in a business organisation

#### Costs

<b>Start up costs</b>	Those costs which are only incurred during the setting up of a new business venture.
<b>Operating costs</b>	Those costs which are incurred by running a business. These costs could be fixed or variable.
<b>Variable costs</b>	Costs which change as output changes, <i>for example raw materials.</i>
<b>Fixed costs</b>	Costs which do not change as output changes, <i>for example administration.</i>
<b>Direct costs</b>	Costs which can be traced directly back to the production process. These costs will usually also be variable costs.
<b>Indirect costs</b>	Costs which cannot be attributed to the production process. These costs will usually also be fixed costs.
<b>Total costs</b>	All the costs of a business. Fixed costs + Variable costs = Total costs Indirect costs + Direct costs = Total costs

#### Revenue

<b>Sales revenue</b>	Money gained from the sale of goods.
<b>Total sales revenue</b>	All the revenue of a business gained from sales. $\text{Price} \times \text{number sold} = \text{Total sales revenue}$
<b>Other revenue</b>	Money gained from other business activities, <i>for example interest from loans made, investment revenue etc.</i>

#### Profit

<b>Profit</b>	The money made after costs have been taken off. $\text{Profit} = \text{revenue} - \text{costs}$
<b>Gross profit</b>	The money made after direct costs have been taken off. $\text{Total sales revenue} - \text{direct costs} = \text{gross profit}$

#### Net profit

The money made after direct and indirect costs have been taken off.  
 $\text{Total sales revenue} - \text{direct costs} - \text{indirect costs} = \text{net profit}$   
OR  
 $\text{Gross profit} - \text{indirect costs} = \text{net profit}$

### Learning Outcome 2 Be able to prepare a break-even analysis

<b>Break even level of output</b>	The number of products/services the business must sell so that they neither make a profit or a loss. Break even level of output is where total sales revenue (income) = total costs (expenditure)
<b>Contribution</b>	$\text{Sales price} - \text{Variable costs}$
<b>Break even calculation</b>	The formulae for finding out the break even level of output.

$$\frac{\text{Fixed costs}}{\text{Sales price} - \text{Variable costs}}$$

OR

$$\frac{\text{Fixed costs}}{\text{Contribution}}$$

<b>Break even graph</b>	A graph which shows the break even level of output. A break even graph should include lines to represent: <ul style="list-style-type: none"> <li>• Fixed costs</li> <li>• Total costs</li> <li>• Total sales revenue</li> <li>• The break even level of output.</li> </ul>
-------------------------	---

<b>Margin of safety</b>	The positive difference between the break even level of output and the actual (or planned).
-------------------------	---

<b>Break even analysis</b>	Using a break even calculation and/or graph to show possible effects on a business's decision making.
----------------------------	---

### Learning Outcome 3 Be able to create a cash flow forecast

<b>Cash inflows</b>	Cash that enters the business, <i>for example sales revenue, loans, interest etc.</i>
<b>Total cash inflow</b>	The sum of all the cash inflows during a period of time (usually one month).
<b>Cash outflows</b>	Cash that leaves the business, <i>for example raw materials, utility payments, salaries etc.</i>
<b>Total cash outflows</b>	The sum of all the cash outflows during a period of time (usually one month).
<b>Opening balance</b>	The cash that business has at the start of the period (usually one month).
<b>Closing balance</b>	The cash that the business has at the end of the period (usually one month). This becomes the opening balance for the next period.
<b>Cash flow</b>	The difference between the total cash inflows and the total cash outflows during a period of time (usually one month).
<b>Cash flow forecast</b>	A prediction of cash inflows and cash outflows for a business, including all of the above elements.

It is important to maintain focus on the current law and practice in this area. The list given above is neither prescriptive nor exhaustive. Where legislation has been revised learners will consider the most up to date version as that will reflect current industry practice.

## DELIVERY GUIDANCE

Financial forecasting for business should be no more numerical than the normal everyday maths involved in working out if a learner has enough money to go to the cinema. This unit is about the practical application of two forecasting techniques; break even analysis and cash flow forecasting.

### Learning Outcome 1

This learning outcome addresses the background knowledge that learners will require about the costs and revenues of a business. The initial approach to this should not be a 'dry' textbook approach of definitions, but rather to pick a number of very different local businesses (primary, secondary and tertiary) and identify the types of costs that they might incur. These might start by being very specific to begin with (e.g. electricity), but could then be classified under the appropriate type of cost (e.g. fixed and indirect operating costs). By using a number of different types of business the learner should be able to identify the types of cost within the context of any given business.

Revenue could be approached in a similar way, and profit can be approached as a function of the difference between cost and revenue. As such, the concept of profit is taught well before any figures need to be introduced and may make learners more comfortable for the numeracy that follows.

The differences between gross and net profit can be conceptually difficult for learners. However, a good understanding of the difference between direct and indirect costs will aid their understanding. There is no requirement to calculate these figures, however more able students will benefit from the introduction of some figures in a case study approach. This case study business could then be the focus for the merit and distinction criteria later on in the unit.

### Learning Outcome 2

A break even analysis is an invaluable technique that should be applied to a very simple scenario first, before adding in more complex figures. An understanding of what this will show a business is far more important than simply being able to calculate or graph a solution. Learners who expect to progress to merit criteria must be able to analyse the factors that may affect the break even, and not just how to do it.

Learners may require help in building up a break even graph and should be supported in every aspect from working out an appropriate axis, through to how to plot a line using a minimum of two points. There is no need to use anything but simple figures in both the calculation and the graph until learners have grasped the basic techniques. Adding context will help to develop a learners understanding for the merit criteria and a case study approach is recommended to aid this.

The use of wall charts and posters can add a great deal to a learners' experience of break even and the production of these items can show the need for accuracy when drawing a break even graph. If learners use different figures, posters can be compared to visually show the differing relationships between output and break even.

The use of ICT should not overshadow the subject knowledge in this area. However, spreadsheets and other modelling tools can provide a different approach to break even analysis that may prove useful. By building up a spreadsheet (perhaps using formulae) and then turning this into a graph, learners can very quickly start to see the relationship between costs and revenue.

For the **merit criterion**, learners should be encouraged to go beyond the techniques as a tool and analyse what might affect the break even level of output in a positive and negative way. This analysis could be done either in the context of a case study or in the context of a real business.

### Learning Outcome 3,

A good place to start is for learners to build up a cash flow of their own inflows and outflows over the past month. At this point the learners will have built up a cash flow statement for themselves; however this learning outcome is about cash flow forecasting. Therefore, learners could use their past months figures to start making predictions about their future cash inflows and outflows and build up a cash flow forecast. This step by step approach should allow learners to understand the concept of a cash flow forecast, before having to deal with the actual technique in a formal manner.

Once the concept is understood, learners could be given a basic template for building up a cash flow for a business

(or they could make one themselves as long as it includes all of the necessary components). They could then be given increasingly complex sets of additions to build into it. Learners are unlikely to be able to complete a 12 month cash flow to begin with, so use 3, 6 and 9 month cash flow forecasts to build up to this.

As with break even, learners will benefit from a local context to base their cash flow forecasts within. This will pave the way for the merit and distinction criteria, and allow learners to see the logic behind large changes to the cash flow that might occur.

For the **merit criterion**, learners should go beyond the technique as a tool and analyse what might affect the cash flow of a business in a positive and negative way. This analysis could be done either in the context of a case study or in the context of a real business.

For the **distinction criterion**, learners should look at the factors they have identified that may affect the cash flow, and use these to develop an argument about how useful cash flow forecasting is as a decision making tool for a selected business. Any judgements/evaluation that is made must be in context to be valid, hence the need for a case study or real business scenario.

## GUIDANCE ON ASSESSMENT

### P1

You are planning to open a new business and need to identify the costs associated.

You should identify type of costs you a likely to incur, and clarify if they are: start up, operating, fixed or variable costs.

Guidance:

Learners could work in small groups to start to identify the associated costs. Alternatively, they could be provided by the tutor.

Learners should then work independently to identify what type the cost is.

### P2 and P3

Using a set of accounts from a local manufacturing business, you have been asked to identify the different types of revenues, and outline the differences between the gross profit and net profit.

Guidance:

Learners must be able to correctly identify the revenue streams and demonstrate an understanding of the differences between gross and net profit. They should use any documentation necessary to complete the task – this could include the business accounts and other literature, Learners could produce a report, presentation, or pictorial chart.

### P4, P5, M1

A local business has asked you to advise them on what their break even level of output would be for a new product they are thinking of manufacturing and what might affect this level of output.

Produce a report for the business including a break even calculation, a break even graph, and an analysis of the factors which may affect the break even level of output.

Guidance:

For a pass learners must have a correctly calculated break even level of output and a correctly labelled break even graph.

For a merit learners must analyse factors that might affect the break even level of output. This could be presented as a report, presentation, chart or information leaflet.

### P6, M2, D1

You have been asked to produce a 12 month cash flow forecast using monthly data for a selected business.

The business is concerned about how accurate your forecast will be. Prepare a presentation for the board of directors analysing the factors that could affect the cash flow forecast.

Within your presentation you should evaluate the usefulness of cash flow forecasting and present your findings to the board of directors.

Guidance:

For a pass learners must have a correctly prepared a 12 month cash flow forecast

For a merit learners must analyse the factors that might affect the cash flow forecast. This could be done by showing the impact of the factors on the given figures.

For a distinction, learners must evaluate the usefulness of cash flow forecasting as a tool for the business.

Learners should choose the business carefully, tutors may wish to assist. It may be beneficial if the chosen business has some form of seasonal cycle e.g. ice cream retailer, toy manufacturer etc.

## MAPPING WITHIN THE QUALIFICATION TO OTHER UNITS

This unit develops skills that are used in Unit 15.

### LINKS TO NOS

**CfA BAD323** Research Information (Partial)

**CfA BAA522** Draft Financial Statements

**CfA BA223** Spreadsheet software



## **CONTACT US**

Staff at the OCR Customer Contact Centre are available to take your call between 8am and 5.30pm, Monday to Friday.

We're always delighted to answer questions and give advice.

**Telephone 02476 851509**

**Email [cambridgetechnicals@ocr.org.uk](mailto:cambridgetechnicals@ocr.org.uk)**

**[www.ocr.org.uk](http://www.ocr.org.uk)**