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FINANCE

Finance is, or can be, a very complex subject, so much so that finance managers are increasingly being trained on specialist programmes distinct from management, and financial management has become a discipline in its own right. Even in small organizations and not-for-profit organizations, there is significant burden of regulation and rules that must be complied with, and specialists are required here too.

But, although the instruments and methods in financial management can be complex, the basics are actually very simple. The finance function of any organization, large or small, private, public or not-for-profit, has three sets of tasks: *management accounting*, the allocation of resources within the organization; *financial accounting*, the presentation of financial data for those outside the company; and *treasury*, the actual management of money including receiving income and disbursing funds. How organizations accomplish these three functions can vary, and each may have a number of subordinate functions. This chapter focuses on understanding those basic functions and processes; for more information on the tools of finance, consult the suggestions for further reading at the end of the chapter.

Although finance is taught as a specialist sub-discipline within management, this does not mean that finance is in some way 'separate' from the rest of business. At the top level, the chief financial officer or finance director is a key member of the board of directors and has an important say in strategy and decision-making in many fields; increasingly, the CFO is regarded as the most important person on the board after the chief executive officer. At

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lower levels, the finance department provides resources and information that the rest of the organization needs if it is to function effectively.

Equally important, the finance department is one of the focal points of liaison between those people and organizations outside the business that provide its capital, the shareholders and debtholders. All organizations are facing increasing pressures not only to behave responsibly, but to be *seen* to be responsible, and reporting is now about much more than providing financial data. Many large shareholders increasingly require ESG (environmental, social, governance) reports from companies they invest in, so that they can be sure these companies are behaving responsibly. The same standards, or versions of them, are being applied by governments and funding bodies to public sector and not-for-profit organizations.

DEFINITIONS

Accounting Accounting at its simplest level is keeping track of the movement and location of money. It is through accounts that organizations know how much money they have, how much they are spending and earning. Analysis of accounts gives critical information such as profitability (how much money is the organization making), and gross expenditure (how much is it spending). Managers use accounts rather as drivers or pilots use maps, to tell them where they are at any given point in time and where they can go next.

Budgeting Budgeting is a form of planning that specifies how much money will be allocated to a particular activity over a given period of time. Financial managers usually prepare overall budgets which state how much money the company will spend on operating expenses, both ordinary costs and costs for special products over a period of time, typically a year. There are two ways of preparing an overall budget; either individual departments, divisions, or business units prepare their own budgets for their own activities and then the finance department aggregates these into an overall budget; or the finance department prepares a framework budget and tells the various other departments and divisions how much money they can spend, leaving each to allocate money more precisely as they see fit.

Capital In finance terms, capital is money put into the organization. Most commonly, capital is raised in one of three ways: (1) by borrowing money directly from banks or other institutions, (2) by the sale of bonds, financial instruments which are sold to investors and then bought back (or 'redeemed') at a specified date in the future, or (3) through the sale of shares, which give investors part ownership in the corporation and the right to a share of its profits (if any). Charities and other not-for-profits will raise money through fundraising and grants from funding bodies, similar to (2) and (3), though no right of ownership is conferred.

Shareholder A shareholder is a person who has purchased a share in the capital of the business as above. In return for their money, shareholders are given 'equity', a stake in the business and its profits. Nearly all companies, even very small ones, operate on the principle of limited liability, meaning that shareholders are not responsible for debts incurred by the company. However, if the company does go bankrupt, the shareholders will probably lose part or all of the money they have invested.

It is important to make a distinction between shareholders and owners. It is commonly assumed that shareholders own the organizations they invest in. In fact, they own equity in the company equivalent to the number of shares they hold, but they have no claim on the company's assets.

Debtholder A debtholder is anyone who lends money directly to an organization. Banks are the most common form of debtholder, but the category can include anyone holding any other debt instrument such as mortgage on property owned by the business. Owners of bonds are also considered to be debtholders, as the ownership of bonds signifies that the person has invested money in the company which is to be paid back; there is no transfer of equity involved.

Risk When planning for the future, nothing can ever be known for certain. This uncertainty leads to risk, the possibility that something might go wrong. We discussed risk in Chapter 2, but finance departments play a leading role in assessing and reporting on risk, not just financial risk but any risks that face the company. The risk register, which describes potential risks, impacts and mitigation, is usually in the keeping of the finance department. We will discuss this in more detail below.

MANAGEMENT ACCOUNTING

The management accounting function of the organization has two principal tasks: first, planning and allocating financial resources, and second, ensuring that resources are used in an appropriate and effective manner. Management accounting is also involved in the development of new products, new investments in technology, entering new markets and the like. At the heart of management accounting lies the need for information, from all parts of the organization, about how much money is being made, how much spent, and how this affects future plans and prospects.

The two key figures that the management accountant looks at are *costs* and *income*, or revenue. Costs include everything that the business will spend in order to operate: wages, raw materials, IT services and digital presence maintenance, technology, rent for premises, insurance, electricity, travel costs for employees and more. Costs are sometimes divided into direct costs, those which are directly incurred in the production of products (primarily wages and materials) and indirect costs, which are incurred by the organization regardless of what it is making and selling. These include items such as insurance, rent and electricity bills.

Another form of cost is depreciation, the wear and tear on machinery and equipment which occurs with use. If a vehicle is purchased for $50,000 and can be expected to last for five years before needing to be replaced, then the vehicle is said to depreciate at a rate of $10,000 a year. Its value after a year of use will be $40,000, after two years $30,000 and so on. Although no money is actually spent on replacing the vehicle during this time, the reduction in value is nonetheless regarded technically as a cost.

Income is what the company earns, primarily but not exclusively through the sale of products and services to customers. Other means of making income might include the sale of redundant technology, buildings or premises, or contracting the right to make products to another organization under a licensing agreement (for example, a maker of electrical generators in South Korea might allow an American company to make the same product under license, paying the South Korean company an annual fee for doing so). The gross earnings of a company are sometimes known as EBITDA (earnings before interest, taxes, depreciation and amortization).

The comparison of income to costs yields a ratio known as income over expenditure. If income is $1 million in the course of a year, and costs are $500,000, then the income over expenditure ratio is said to be 2:1. However, another factor then has to be determined, namely whether there are any other charges the organization must pay out of its income. The most important of these are repayment of debts and payment of taxes – taxes cannot be declared as a cost – and this will reduce the amount of money available. If in the example above the organization then pays $250,000 in tax after depreciation and amortization of loans (unlikely, but a simplification for our purposes), the net income, after taxes, would be $750,000. This yields a ratio known as profitability or profit to loss, which is net income (total income less tax and other charges) compared to costs. In the above example, the profit to loss ratio would be 1.5:1. Calculating a little further, we see that the organization is then left with $250,000 in profits ($1 million income, less $500,000 in costs, less $250,000 in taxes).

When planning and allocating resources, management accounting estimates overall costs and income from all the various activities of the business, and builds up a composite forecast of what the year (or two years, or three, whatever the reporting period might be) ahead might hold. If it looks like income will exceed costs by a reasonable margin, that is good; the organization will have a financial surplus, which it can reinvest in operations, pay out as dividends to shareholders or some combination of the two, as the board of directors decides. If income and costs will be closely matched, or costs will exceed income, then other measures may need to be taken. A company can run at a loss – though more capital may need to be raised to cover the loss – for a time, but not indefinitely. For other organizations, the line is much harder; charities in the UK, for example, are only allowed to run deficit budgets if they can cover the deficit out of existing reserves.

The outcome of this planning process has an effect on almost everything the company does. The amount of money the organization is forecast to make - or lose - in the coming year determines how much it can afford to spend on developing new products or investing in new technology. If the results are unsatisfactory, managers will have to look at other areas. Can costs be saved, by reducing overheads or wages? Can the price of its goods and

services be raised? Ideally, of course, these are not decisions that are made only when a crisis point is reached; rather, financial managers and managers of other departments should be in constant touch, looking at ways of increasing revenue and ensuring costs are at an optimum level. This should not be a case of the finance department telling the other departments what to do: rather, all departments should work together to interpret what the financial forecasts might mean. Good communication between departments and functions is essential.

Once this is done, budgets are then prepared, usually on an annual basis, for each department and business unit. This involves detailed planning of expenditure over the coming year, not forgetting an allowance for unforeseen events or emergencies. The latter is known as contingency planning. One of the key activities of the finance department is assessing risk: that is, what might happen to throw plans off their course, and if they do go off course, what are the financial implications? The company tries to anticipate what risks it is running and anticipate future unplanned events, and then develop alternative plans which can be put into place if such an event occurs. For example, if a key piece of equipment breaks down and must be replaced, there may be a contingency plan for such an event, with costs savings then being made elsewhere. We will come back to risk in more detail in a moment.

Finally, there is the monitoring of expenditure and income, the activity most of us think of first when we think of accounting. All expenditure and income, no matter where in the business, must be recorded and reported to management accounting. If this does not happen, then there is a risk that the final figures for the year will be inaccurate and the organization's picture of its financial performance will not be a true one. There is also a risk that, if the transfer of money is not recorded, money could actually get lost – or worse, stolen. The problem of accounts not reflecting an accurate picture of performance has been highlighted in the media by a series of accounting scandals over the last few decades. Names such as Enron, WorldCom, Wirecard, Tesco, Satyam and Carillion have made headline news around the world, but there have been many others as well.

At the end of the reporting period, management accounting totals income, profit and costs and reports on financial performance

to the board. At this point the information becomes the province of the second finance function, financial accounting. Note that in many organizations, especially smaller ones, management accounting and financial accounting are actually done by the same people and have many areas of overlap; nevertheless the two activities have separate purposes, and are treated separately here.

FINANCIAL ACCOUNTING

Whereas management accounting looks inside the organization, financial accounting presents factual information about the company to shareholders, debtholders, regulatory bodies and government tax authorities. All of these will require such information on at least an annual basis, and very often quarterly or even monthly. The key document prepared by financial accountants is the financial statement, which shows profit and loss for the past year, forecasts profit and loss for the coming year, and spells out in detail what money will be spent on and how revenue will be distributed between shareholders, debtholders and re-investment in the organization.

These annual statements are also supplemented by more frequent reports and forecasts. Major shareholders or large funders such as banks will want regular information. If the company's shares are traded on a stock market (see below), then markets too will want reports, especially if the company's fortunes look like changing. An example of such a report is the profit warning, which most companies are required to issue if their shares are traded publicly. If a company has issued an annual forecast that its profits for the period to come will be a certain amount, say $10 million, and then if part way through the period managers find that profits will only be $5 million, they are duty bound to report this publicly. Failure can lead in many jurisdictions to fines being imposed by the market or other regulators, and will also anger shareholders.

One of the central issues in management accounting is the notion of transparency. This means that the organization's internal financial workings must be visible and understandable to the outside world, and others who have a stake in the organization must be able to see clearly that management is running it efficiently,

effectively and honestly. Regular reports – and stringent penalties for false reporting – are intended to ensure transparency. Directors are required by law to approve and sign all financial statements guaranteeing that they are accurate; if it later transpires that the statements are not accurate and if criminal intent is proved, then directors can face fines and prison terms.

Another method of insuring transparency is through auditing. All accounts and financial statements are double-checked by another party before being issued. Many businesses have internal auditors who in effect check the work of other members of the finance department. Large corporations also have an audit committee, often chaired by a non-executive director, which checks final financial statements and reports directly to the board. Finally, organizations of all types are required by law almost everywhere to submit all their accounts and records to an independent auditor, usually a chartered accountant or accounting firm, who checks for accuracy. The independent auditor is to ensure that there has been no criminal activity, such as theft of money or concealing funds to avoid paying taxes, and that the organization is not insolvent and is a going concern, but auditors may also be asked to advise on accounting practices and reporting more generally as well.

Organizations, especially those that are performing badly, are sometimes reluctant to disclose information which shows management in a negative light. They will take various measures to camouflage bad news; profit warnings, for example, may blame external factors for reduced profits and then claim the problem is outside the control of management. Transparency is often seen as something to be complied with grudgingly and only to the letter of the law in order to avoid penalties. In fact, transparency usually tends to work to the benefit of the business and its managers. 'Coming clean' with shareholders and debtholders is nearly always the best policy, especially if potential problems are exposed early enough for preventive measures to be taken. Shareholders and debtholders respect good, honest managers; they dislike and distrust those that they think are being less than fully honest.

The reason why shareholders and debtholders behave in this way, of course, is because they have given the business their money, and as long as shareholders hold equity or debtholders have made loans or bought bonds, then the organization and its

managers have custody of that money. They have a moral and legal responsibility to use that money wisely and return it, with profits, to the debtholders and to pay a portion of their net profits to shareholders. The rules that govern this moral and legal responsibility are known as *corporate governance*. On one level, corporate governance spells out the legal rules by which managers must abide. On another level, however, it reminds managers that they do not own the organizations that they run, not unless they themselves own large numbers of shares. Otherwise, they are merely stewards or custodians, duty bound to manage the organization to the best of their ability, and to render full and frank accounts of their work when requested.

Increasingly, organizations are being asked to report not just on their financial affairs but on other impacts they may be having on the world around them. There is a growing trend towards ESG (environmental, social and governance) reporting. Major investment funds, venture capital groups and banks now require companies to provide ESG reports along with financial reports so they can see clearly that these organizations are well governed and are taking real steps to reduce their environmental impacts and make a positive social contribution in the companies where they operate. At time of writing, ESG reporting is not yet required by law in most jurisdictions, but it seems likely that more countries will pass laws requiring ESG reporting in the near future.

Because financial managers have access to so much information about their organizations, they are often best placed to provide ESG reports. They have data that can demonstrate what impacts the organization is having, positive and negative, on the world around it. This reporting is good discipline for the organization as well. By complying with ESG requirements, managers can get a better idea of what they need to do, for example, to transition towards a circular economy model. Understanding where we are now and where we want to be shows us the gap between the two positions, and gap analysis can then be used to show where we need to make changes. There is evidence that commercial companies with strong, positive ESG reports also perform better in terms of profitability and share price, and are more competitive and more resilient.

TREASURY

The treasury function actually handles the money. It receives income and channels it to the appropriate destinations, such as bank accounts, and it handles disbursements. It issues shares, oversees the placing of these in stock markets where they can be sold to shareholders, and takes receipt of funds raised. It takes in money lent by debtors and received through the sale of bonds. In charities, where the organization is required to hold reserves to see it through in case funding should dry up, the treasury function oversees the prudent investment of reserves so that they earn interest or dividends but are also available in case of need. The Church of England, for example, holds large portfolios of shares and land investments, and a treasury function is needed to manage these.

The treasury function also ensures that the money received, from whatever source, is used as efficiently as possible. If money is held in banks, the treasury function looks to get the best rate of interest possible, swapping money around from one account to another in search of the best deal. When millions of dollars are being held in bank accounts, even a tiny difference in interest rates can make a great deal of difference in terms of revenue.

For organizations operating across national boundaries (companies but also non-governmental organizations such as international aid charities), there is also the need to handle foreign currency transactions. An American company with an operating unit in Germany, for example, will receive income in Germany in the form of euros. Some of these euros will be used to pay costs and re-invest in Germany, but it may still be necessary to 'repatriate' some of these euros to America. What then should be done? Banks in America will allow the company to open a euro account, but the euros cannot be spent in America. In order to spend it, the money will need to be exchanged into dollars, and this incurs costs. Most major international currencies also 'float' against each other: that is, their values have been determined by international currency markets, where dealers set prices according to the perceived strength and weakness of each economy. Financial managers dealing across boundaries have to keep a close eye on currency movements. If on Monday the euro is worth 98 cents US, and on

Tuesday rises to 99 cents US, the consequences for a company transferring 100 million euros are considerable; the euros are worth a million dollars less on Tuesday than they would have been on Monday. Sometimes companies will choose to hold onto their foreign currency for as long as they can, seeking a favourable exchange rate, but this is not always possible.

Two issues that further concern the treasury function are how many shares to issue and how much money to borrow. The issuing of shares requires a calculation of the value of the company and whether the issuing of further shares reduces the value of shares held by existing shareholders. This reduction in value is known as *dilution*. The calculation of dilution can be made quite simply. Suppose a company is valued at $1 million dollars. This is the money that would, in theory, be yielded if the company sold all of its assets and turned them into cash, including all its equipment and premises, any products in stock, outstanding contracts and the like, and paid off all its debts. The company has 100,000 outstanding shares. Each shareholder thus has $10 of equity for each share he or she holds (this is not necessarily related to the price the shares sell for, we will come onto this in a moment). Now suppose the company wishes to raise more money and decides to issue a further 100,000 shares. As the company is only worth $1 million, this means that with 200,000 outstanding shares, each shareholder would only have $5 per share. Not surprisingly, existing shareholders would object to this, and might try to block the new issue or would sell their shares before it took place.

However, if the company value were to double to $2 million, it might be able to make a persuasive case for issuing new shares, especially if it offered them to existing shareholders at a cheaper price, and thus avoid dilution. Dilution becomes less of an issue if the company's share price is higher than the asset value of each share – the difference will be explained below – shares will be in demand and can be sold profitably by current shareholders.

As to how much debt the organization should take on, opinions vary. Perhaps surprisingly, it is not always considered desirable for an organization to be debt-free; it may be that it can use its assets more effectively by borrowing against them. The ratio of debt to the value of the organization is known as gearing; for example, if a company worth $100 million in share value has debts of $40

million, it is said to be geared at 40 per cent. Generally, shareholders start to worry if gearing goes up to about 50 or 60 per cent, as the company will then be paying out large sums in interest which will have a negative effect on net profits, and the high level of debt will also reduce the overall value of the company. Gearing must not be allowed to reach 100 per cent, because if debts exceed assets the company is then deemed to be insolvent and no longer viable. In many jurisdictions it is illegal to trade while insolvent, and companies that reach this position can be broken up or dissolved. The company must then decide how to raise the money, through loans or by issuing bonds.

MONEY MARKETS

Loans are negotiated directly with banks and other lenders (sometimes, organizations will lend money to each other, without the need to go to a bank), but shares and bonds are sold in what are known as money markets. There are markets in everything from foreign currency to futures (markets for goods which have not yet been produced but will be produced in future) to hedge instruments (bets against certain events coming to pass) and many more. As space is limited we will stick to the two most basic and common money markets, the stock market and the bond market.

Stock markets are where shares are sold. Companies wishing to issue equity make what is known as a placement, issuing shares and then placing these with a broker who in turn sells them on commission to investors. Investors come in several different forms. Private investors are individuals who buy for themselves, while institutional investors are large organizations such as pension funds and insurance companies who buy shares in order to earn money for their own business purposes. Income investors are those who buy shares in order to make money from dividends, portions of the company's net profit which are paid out annually to shareholders, while growth investors are primarily concerned with seeing the value of their shares grow so that they can sell them on at a profit. In general, institutional investors are more interested in income while private investors are more interested in growth, but there are plenty of exceptions to both rules.

Once shares have been issued, of course, the shareholder is usually free to sell their shares to someone else. The company that

issued the shares cannot control either the sale itself or the price for which the shares are sold; the shares, once issued and paid for, are the property of the shareholders, who can do with them as they see fit. Companies by and large prefer to see their shareholders keep their shares rather than sell them, as this makes it possible to build long-term relationships with shareholders. Also, if shares are sold, there is a risk that they will be sold to a rival company. The practice of take-overs, buying up the shares of competitors and then incorporating the business into that of the buyer or closing it down altogether, is a common competitive tactic.

Companies also like to see the price of their shares at a high level, in part because it discourages rivals from buying their shares, and in part because if the price at which the shares trade is higher than the asset value, then there are opportunities to issue more shares with less risk of dilution. The difference between the market value of a share and its equity value is simply the difference between what people are willing to pay for a share and what the share represents in terms of a proportion of the company's equity. In the example above we talked about a company valued at $1 million, with 100,000 shares. These have an equity value of $10 each. However, if the company is deemed to be well managed and has good prospects for growth, investors may decide to buy shares in it now. There develops a competition for the shares, with those who currently own them charging whatever buyers are willing to pay; the price could rise to $12, $15 or even $20 depending on how confident investors are feeling.

Much depends on market sentiment, what investors feel the prospects for the company might be. During the late 1990s, e-commerce companies known colloquially as dotcoms saw the market value of their shares rise to many times that of their actual assets value; companies whose assets were valued at only a few hundred thousand dollars saw the total market value of their shares rise to tens of millions of dollars, or more. Eventually, the market realized that the promises of growth were not going to come true, and the value of the shares crashed to nearly nothing. More recently, investors have been willing to buy shares in tech companies and social media platforms that are making little or no profit, in the belief that the platforms they have developed will one day become highly profitable. Uber has lost money steadily since it was

first launched on the stock market in 2019, and in the first quarter of 2021 posted its largest ever loss, $5.24 billion, yet investors still have faith in the company.

Investors react quickly to news of either good fortune or bad fortune. We come back here to the issue of transparency. Even if a company has done nothing wrong, even a whisper that it might have will see investors sell shares rapidly and cause the share price to plunge. Good, transparent communications with shareholders are essential if the value of the shares is to hold up.

Bond markets are somewhat simpler. Although there is a bewildering variety of different types of bonds, most have a few simple features in common. The bondholder buys bonds, and the company is then free to use the money as it sees fit. In exchange, the company promises to redeem the bond, i.e. buy it back, at a specified date in the future, paying the bondholder a premium over and above what he or she purchased the bond for. Income on bonds is usually lower than for stocks, often only 2–4 per cent a year, but bonds are also seen as less risky because their value does not fluctuate. In order to successfully issue bonds, however, the company must be confident that it will have the money to redeem the bonds on the date specified.

RISK MANAGEMENT

Finance departments are ideally placed to measure and understand the risks the company faces, and it is not uncommon for them to take the lead in activities such as analyzing risk and preparing the risk register. Even when they do not, financial managers are still heavily involved in risk management.

In his book *Fundamentals of Risk Management*, Paul Hopkin classifies risks into four basic types: *hazard risk, control risk, opportunity risk* and *compliance risk*. Hazard risks are the things that most often combine when people think about risk; they include things such as theft and fraud, disasters such as fires or floods, health and safety and the consequences of defective products. Hazard risk can mean the threat to people (i.e. a danger to health or life), the threat to premises (fire or flood), the threat to processes (technology failures, cyber attacks) and the threat to products (most commonly, the failure of a product which somehow causes harm to customers or consumers).

Control risk, or uncertainty risk, arises when we do not have full control over what happens to the organization. Control risks happen for example in supply chains, when managers have to rely on external partners to maintain supply and distribution. The risk that shareholders might sell their shares to a rival company can also be classified as a control risk. Opportunity risk arises when we embark on a new strategy or invest in a new venture; what are the things we don't know about the future, what are the uncertainties that could come back to bite us? Finally, compliance risk is the risk we face if we are not fully compliant with laws and regulations in our industry.

Within this broader framework, organizations of every type need to assess the risks they face and understand exactly what they are. Different organizations will face different types of risk even in the same sector, depending on size, maturity, geographical markets and many other factors. Each organization should compile a risk register which lists risks and gives an assessment of their *probability* (the likelihood that an event will happen) and *impact* (how damaging it would be if it did happen) along with steps to mitigate each risk. It is common practice to score both dimensions, probability and impact, from 1 to 5, with one representing low probability or low impact, and 5 representing high. The numbers can be multiplied together to get a total risk score; e.g., a risk with a moderate probability of happening (3) and a fairly low impact (2) would have an overall score of 6, while a risk with a high probability of happening (4) and a very serve impact (5) would score 20. Risks are sometimes colour coded with a red-amber-green (RAG) rating: risks with a score of 20–25 are coded red, those with a score 10–19 are coded amber and those with a score of 1–9 are coded green. The company can thus see at a glance which are the most dangerous risks it faces and which need the most attention.

The final step in risk management is mitigation, or reducing the level of the risk. There are generally speaking five tactics for mitigation of risk:

1 **Avoidance.** This means eliminating the risk altogether, usually by putting a halt to activities that give rise to that particular risk and so cutting off the problem at its source. If the organization is operating in a region with high levels of insecurity, to avoid hazard risk it might decide to sell its operations and leave that market entirely.

2 **Reduction.** If complete avoidance is not desirable, the company could still reduce associated activities in order to bring down levels of risk. This could mean scaling back operations in a particular region or market, or limiting investment in a new venture so that if it fails, not too much will have been lost.
3 **Alternative actions.** Similar to reduction, the company might also consider what alternative actions might be taken to reduce risk. Could technology be employed to reduce health and safety risks to employees? Would buying up suppliers or distributors and integrating them into the company give greater control over the value chain and reduce control risk?
4 **Share or insure.** There are several ways of sharing risk. One is to buy insurance; this spreads the financial load, with insurers committed to paying for a portion of whatever damage is done. The other is through partnerships and joint ventures. Entering foreign markets for the first time is very risky, and companies will often partner with a local firm that knows market conditions and has an established presence.
5 **Accept.** Sometimes, a risk assessment suggests that the risk is worth taking, because any steps to mitigate it will not be cost-effective. This usually means either low-impact risks (minor disruptions to supply lines, loss of non-essential personnel) or high-impact risks with a very low probability (meteorite strike on headquarters).

Assessments of risk and mitigation have to be thorough and realistic. Organizations often persuade themselves that risk is low, when in fact the reverse is the case. Prior to 2020, governments and other organizations around the world believed a risk of a pandemic was very low, clearly ignoring a World Health Organization warning that the chances of a global pandemic were rated at 100 per cent; in other words, the question was not whether a pandemic would happen, but when.

SUMMARY

- The finance function manages the flow of money in an organization, and is responsible for reporting and control.

- Financial resources have to be planned, forecast and budgeted through management accounting.
- Statements of an organization's financial position need to be prepared through financial accounting.
- An organization's money and debts need to be managed through the treasury.
- In all financial management, communication and transparency are essential in order to ensure accuracy of information and adherence to legal and moral standards.

SUGGESTIONS FOR FURTHER READING

Brealey, R.A. and Myers, S.C., *Principles of Corporate Finance*, New York: McGraw-Hill, 2019. A textbook for students, which goes into many of the tools and methods of financial management in great deal; strongly recommended. The introductory chapters treat key themes and are worth reading in any case.

Esty, D.C. and Court, T., *Values at Work: Sustainable Investing and ESG Reporting*, Basingstoke: Palgrave Macmillan, 2020. An excellent introduction to ESG reporting and the trend towards sustainable investment.

Hopkin, P., *Fundamentals of Risk Management: Understanding, Evaluating and Implementing Effective Risk Management*, London: Kogan Page, 2018. One of the best current books on risk management, accessible and full of tools for analyzing and understanding risk.

Melville, A., *International Financial Reporting: A Practical Guide*, London: Pearson, 2019, 8th edn. Financial reporting is an increasingly complex subject, and this is a good up-to-date guide.

Melvin, M. and Norrbin, S., *International Money and Finance*, New York: Academic Press, 2017, 9th edn. Offers another dimension on top of Brealey and Myers, describing the international dimensions of financial management and working in international financial markets.

Pilbeam, K., *International Finance*, Basingstoke: Palgrave Macmillan, 2013. Another good introductory textbook describing the principles of international finance.