Financial Controls:

Every business wants to make a profit. To do this, managers need to keep track of their finances and make sure the company is spending wisely, earning enough, and staying on track financially. Financial controls help managers make smart decisions by analyzing key numbers and reports.

1. **Analyzing Budgets:**
   Budgets are plans for how money will be spent. They are also tools for control. Managers compare actual spending or income against the budget to see if they're on track. For example, if spending in one area is too high, they can adjust by cutting costs elsewhere or finding ways to bring in more income.
2. **When Managers Use Financial Controls:**
   - **Before Work Starts:** (Feedforward control) To ensure everything is set up properly to avoid problems.
   - **During Work:** (Concurrent control) To monitor and fix issues while tasks are happening.
   - **After Work:** (Feedback control) To review results, see what went well, and fix problems for the future.

In short, financial controls help businesses track their money, avoid waste, and make better decisions to achieve their goals.

his table explains common **financial ratios** used by businesses to analyze their financial health. Each ratio falls under one of four objectives: **Liquidity, Leverage, Activity, and Profitability**. Here's what they mean in simple terms:

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1. Liquidity Ratios

These measure whether a company has enough short-term assets to pay off its short-term debts.

- **Current Ratio:**
  Formula: Current Assets ÷ Current Liabilities
  Meaning: Checks if the company can pay its short-term bills with the money it has (e.g., cash, receivables, inventory). A higher ratio indicates better ability to pay.
- **Acid Test (Quick Ratio):**
  Formula: (Current Assets – Inventories) ÷ Current Liabilities
  Meaning: Similar to the current ratio but excludes inventory because it might not sell quickly. This provides a stricter test of liquidity.

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2. Leverage Ratios

These show how much debt the company is using compared to its assets and its ability to handle debt payments.

- **Debt to Assets:**
  Formula: Total Debt ÷ Total Assets
  Meaning: Shows what percentage of the company's assets are financed by debt. A higher ratio means the company relies more on borrowing, which could be risky.
- **Times Interest Earned:**
  Formula: Profits Before Interest and Taxes ÷ Total Interest Charges
  Meaning: Measures how easily the company can pay interest on its debts. A higher number means the company is better at covering interest payments.

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3. Activity Ratios

These measure how efficiently a company is using its resources (like inventory or assets).

- **Inventory Turnover:**
  Formula: Sales ÷ Inventory
  Meaning: Shows how often the company sells and replaces its inventory in a period. A higher ratio means inventory is being used efficiently.
- **Total Asset Turnover:**
  Formula: Sales ÷ Total Assets
  Meaning: Indicates how efficiently the company uses its assets to generate revenue. Higher numbers mean better asset usage.

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4. Profitability Ratios

These assess how effectively the company is generating profits from its resources.

- **Profit Margin on Sales:**
  Formula: Net Profit After Taxes ÷ Total Sales
  Meaning: Shows the percentage of revenue left as profit after all expenses. Higher margins mean the company is more profitable.
- **Return on Investment (ROI):**
  Formula: Net Profit After Taxes ÷ Total Assets
  Meaning: Measures how well the company uses its assets to generate profit. A higher ROI means more efficient use of investments.

Why These Ratios Matter:

- They help managers and investors **evaluate financial health**, **spot problems**, and **make decisions**.
- Liquidity ratios ensure short-term stability.
- Leverage ratios assess financial risk.
- Activity ratios reveal efficiency in operations.
- Profitability ratios show how well the company is turning efforts into profits.

Using these ratios together provides a full picture of the company's financial performance!

Objective	Ratio	Calculation	Meaning
Liquidity	Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	Tests the organization's ability to meet short-term obligations
	Acid test	$\frac{\text{Current assets less inventories}}{\text{Current liabilities}}$	Tests liquidity more accurately when inventories turn over slowly or are difficult to sell
Leverage	Debt to assets	$\frac{\text{Total debt}}{\text{Total assets}}$	The higher the ratio, the more leveraged the organization
	Times interest earned	$\frac{\text{Profits before interest and taxes}}{\text{Total interest charges}}$	Measures how many times the organization is able to meet its interest expenses
Activity	Inventory turnover	$\frac{\text{Sales}}{\text{Inventory}}$	The higher the ratio, the more efficiently inventory assets are being used
	Total asset turnover	$\frac{\text{Sales}}{\text{Total assets}}$	The fewer assets used to achieve a given level of sales, the more efficiently management is using the organization's total assets
Profitability	Profit margin on sales	$\frac{\text{Net profit after taxes}}{\text{Total sales}}$	Identifies the profits that are being generated
	Return on investment	$\frac{\text{Net profit after taxes}}{\text{Total assets}}$	Measures the efficiency of assets to generate profits

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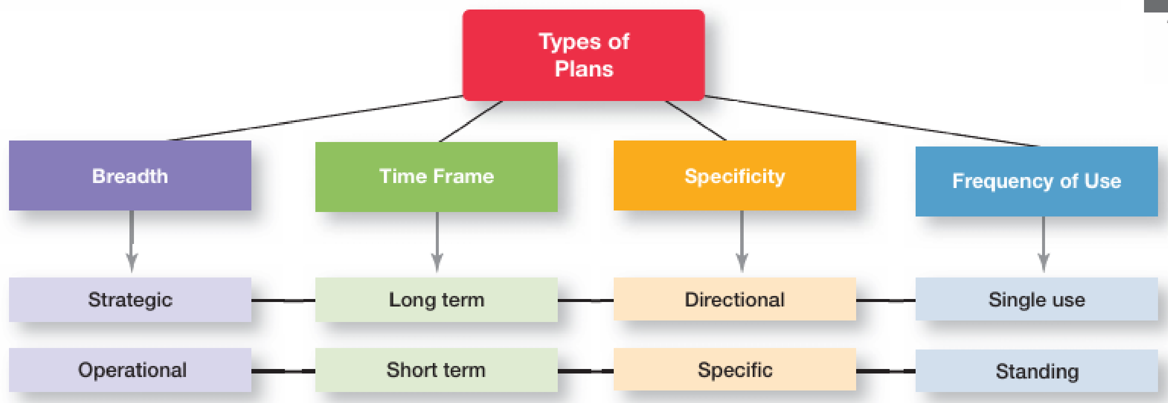

Types of Plans

The most popular ways to describe organizational plans are breadth (strategic versus operational), time frame (short term versus long term), specificity (directional versus specific), and frequency of use (single use versus standing). As Exhibit 8-1 shows, these types of plans aren't independent. That is, strategic plans are usually long term, directional, and single use whereas operational plans are usually short term, specific, and standing. What does each include?

Strategic plans are plans that apply to the entire organization and establish the organization's overall goals. Plans that encompass a particular operational area of the organization are called **operational plans**. These two types of plans differ because strategic plans are broad while operational plans are narrow.

The number of years used to define short-term and long-term plans has declined considerably because of environmental uncertainty. Long-term used to mean anything over seven years. Try to imagine what you're likely to be doing in seven years and you can begin to appreciate how difficult it would be for managers to establish plans that far in the future. We define **long-term plans** as those with a time frame beyond three years.[10] **Short-term plans** cover one year or less. Any time period in between would be an intermediate plan. Although these time classifications are fairly common, an organization can use any planning time frame it wants.

Intuitively, it would seem that specific plans would be preferable to directional, or loosely guided, plans. **Specific plans** are clearly defined and leave no room for interpretation. A specific plan states its objectives in a way that eliminates ambiguity and problems with misunderstanding. For example, a manager who seeks to increase his or her unit's work output by 8 percent over a given 12-month period might establish specific procedures, budget allocations, and schedules of activities to reach that goal.

However, when uncertainty is high and managers must be flexible in order to respond to unexpected changes, directional plans are preferable. **Directional plans** are flexible plans that set out general guidelines. They provide focus but don't lock managers into

[redacted]

strategic plans
Plans that apply to the entire organization and establish the organization's overall goals

operational plans
Plans that encompass a particular operational area of the organization

long-term plans
Plans with a time frame beyond three years

short-term plans
Plans covering one year or less

specific plans
Plans that are clearly defined and leave no room for interpretation

directional plans
Plans that are flexible and set out general guidelines

single-use plan
A one-time plan specifically designed to meet the needs of a unique situation

standing plans
Ongoing plans that provide guidance for activities performed repeatedly