Citrus Business Management Programme

Module 6

Manage your Business: Finance for Agribusiness Managers

Learner Guide

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Scientific Roets

Citrus Growers' Association of Southern Africa
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Contents

Directions

Unit Standard Information

Manage general administration

SAQA US ID	**UNIT STANDARD TITLE**			
114805	Manage general administration			
ORIGINATOR				
SGB Hairdressing Cosmetology and Beauty				
PRIMARY OR DELEGATED QUALITY ASSURANCE FUNCTIONARY				
-				
FIELD			**SUBFIELD**	
Field 11 - Services			Personal Care	
ABET BAND	**UNIT STANDARD TYPE**	**PRE-2009 NQF LEVEL**	**NQF LEVEL**	**CREDITS**
Undefined	Regular	Level 4	NQF Level 04	4
REGISTRATION STATUS		**REGISTRATION START DATE**	**REGISTRATION END DATE**	**SAQA DECISION NUMBER**
Reregistered		2015-07-01	2018-06-30	SAQA 10105/14
LAST DATE FOR ENROLMENT		**LAST DATE FOR ACHIEVEMENT**		
2019-06-30		2022-06-30		

In all of the tables in this document, both the pre-2009 NQF Level and the NQF Level is shown. In the text (purpose statements, qualification rules, etc), any references to NQF Levels are to the pre-2009 levels unless specifically stated otherwise.

This unit standard does not replace any other unit standard and is not replaced by any other unit standard.

PURPOSE OF THE UNIT STANDARD

The person credited with this unit standard is able to correctly process payments to suppliers, employees and vendors and manage and co-ordinate all promotional activities to general sales

The qualifying learner is capable of:

- Processing payments
- Co-ordinating and monitoring promotional activities
- Controlling and dealing with confidential information and documents
- Implementing control measures with individuals

LEARNING ASSUMED TO BE IN PLACE AND RECOGNITION OF PRIOR LEARNING

Learners accessing this qualification will have demonstrated competence against unit standards in mathematical, computer, numerical and communication studies at NQF Level 3 or equivalent.

UNIT STANDARD RANGE

- Staff and labour costs, include but are not limited to: legislative requirements, salary. Commission etc
- Operating costs include but are not limited to: water, lights, equipment hire etc
- Promotional resources include but are not limited to; people required, products required, advertising material requirements etc

Manage finances of a new venture

SAQA US ID	**UNIT STANDARD TITLE**			
263474	Manage finances of a new venture			
ORIGINATOR				
Task Team - New Venture Creation				
PRIMARY OR DELEGATED QUALITY ASSURANCE FUNCTIONARY				
-				
FIELD			**SUBFIELD**	
Field 03 - Business, Commerce and Management Studies			Generic Management	
ABET BAND	**UNIT STANDARD TYPE**	**PRE-2009 NQF LEVEL**	**NQF LEVEL**	**CREDITS**
Undefined	Regular	Level 4	NQF Level 04	6
REGISTRATION STATUS		**REGISTRATION START DATE**	**REGISTRATION END DATE**	**SAQA DECISION NUMBER**
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This unit standard replaces:

US ID	**Unit Standard Title**	**Pre-2009 NQF Level**	**NQF Level**	**Credits**	**Replacement Status**
114586	Manage finances of a new venture	Level 4	NQF Level 04	5	Complete

PURPOSE OF THE UNIT STANDARD

This Unit Standard is intended for learners who have to manage the finances of a business venture. Learners who achieve this Unit Standard are able to manage the income and expenditure of own business and base financial decision-making on financial data.

Learners credited with this unit standard will be able to:

- Explain financial aspects involved in running new venture.
- Apply cash flow management in the running of a new venture.
- Apply an accounting system to manage a new venture.
- Analyse an income and expenditure statement.
- Analyse a balance sheet.
- Make a financial decision based on financial statements.

LEARNING ASSUMED TO BE IN PLACE AND RECOGNITION OF PRIOR LEARNING

It is assumed that the learner has the following knowledge and skills:

- Communication at NQF Level 3.
- Mathematical Literacy at NQF Level 3.

UNIT STANDARD RANGE

N/A

Using the Learner Guide

This learning material has been developed to assist the learner wishing to complete this unit standard. The guide contains all necessary learning to ensure that the learner will attain the competencies required by the unit standard.

The learner guide is accompanied by formative and summative portfolio of evidence (PoE) guides. Please ensure that you have access to these guides as well. The learner guide was designed to be used by a learner during the presentation of a skills programme based on the unit standard and to be kept afterwards by the learner for reference purposes. The PoE guides were designed to be completed during and after the presentation of the skills programme and forms part of the assessment process.

Background Information

The main theme of this module is the establishment of admin and financial management systems in entrepreneurial businesses. Note that this module has been contextualised for agribusiness.

The module will cover aspects such as:

- Administration systems for:
  - processing payments
  - coordinating marketing and promotional activities
  - controlling and keeping records of confidential information
  - monitoring and controlling staff performance and discipline
- Understanding the financial aspects involved in running an agribusiness
- Cash flow management
- Accounting systems
- Analysis of financial statements
- Financial decision making

This module contributes to the exit level outcome and associated criteria:

4. Manage a new venture by applying business principles and techniques.

   4.1 A business plan for a new venture is developed using strategic planning principles and techniques.

   4.2 Guidelines for the implementation and monitoring the strategic action plan are formulated in terms of milestones and timeframes.

   4.3 Financial management planning principles and techniques are applied in order manage the business in an efficient and effective manner.

   4.4 Production and / or operations management is applied in a chosen business opportunity.

This module comprises of 2 unit standards and attracts 10 credits.

This module is aligned to unit standards:

Section 1	**Business Administration**	114805	Manage general administration	C	4	4
Section 2	**Financial Management**	263474	Manage finances of a new venture	C	4	6

Learning Outcomes

This learner guide has the following learning outcomes:

Section 1 – Business Administration Systems

1. Process payments.
   1.1. Payments to suppliers are processed within agreed timeframes and in accordance with company standards.
   1.2. Payments to staff and casual labourers are processed within agreed timeframes and in accordance with company standards.
   1.3. Payments for operating costs and rent are processed within agreed timeframes and in accordance with company standards.
2. Co-ordinate and monitor promotional activities.
   2.1. Promotional plan or activities list is obtained and analysed.
   2.2. Resources required for planned promotion are identified and obtained.
   2.3. Promotional plan is put into place.
   2.4. Promotion is monitored towards achievement of objective.
   2.5. Inadequacies are identified and corrective action implemented.
3. Control and deal with confidential information and documents.
   3.1. Confidential information is defined and described for a specific organisation.
   3.2. The system and procedures used for dealing with confidential information is explained with examples.
   3.3. Documents are secured in an appropriate manner and within an agreed time frame.
   3.4. Utmost care is taken to avoid compromising any relevant stakeholder.
4. Implement control measures with individuals.
   4.1. Contracted control measures are implemented and non-conformances are identified for reporting to person with the authority to deal with them.
   4.2. Non-conformances are recorded and corrective actions negotiated according to organisational requirements.
   4.3. Reported non-conformances is handled in accordance with organisational policies and procedures and is duly recorded.

Section 2 – Financial Management

1. Explain financial aspects involved in running new venture.
   1.1. The concepts of start-up capital and working capital are explained in relation to a business.

1.2. The relationship between cash flow and profit are explained with examples within a business.

1.3. An explanation is given of the difference between short-term finance and long-term debt finance with examples.

1.4. The difference between fixed and working capital is explained in terms of own business venture.

2. Apply cash flow management in the running of a new venture.

2.1. The importance of cash flow management in a business is discussed in terms of the principles of a healthy business practice.

2.2. An explanation is given of the use of cash flow forecast as a budgeting tool.

2.3. A cash flow forecast is created in accordance with recognised processes and steps.

2.4. A cash flow forecast is used in order to determine a working capital for a business.

2.5. Bank statements are interpreted for reconciliation with the cash book.

3. Apply an accounting system to manage a new venture.

3.1. An explanation is given of how an accounting system is applied in a new venture.

3.2. An accounting system is established for a new venture.

3.3. The accounting system is monitored for effectiveness.

3.4. Taxation requirements are catered for in the accounting system of the new venture.

4. Analyse an income and expenditure statement.

4.1. An explanation is given of how income and expenditure statements are applied in terms of their purpose.

4.2. Sources of income and expenditure statements are identified for a new venture.

4.3. Income and expenditure statements are evaluated to determine the financial viability of new venture.

4.4. An income and expenditure statements is created for a new venture.

5. Analyse a balance sheet.

5.1. An explanation is given of the purpose of a balance sheet with reference to how often a balance sheet is necessary.

5.2. The liabilities in a balance sheet are classified in terms of long-term and current liabilities.

5.3. Assets and liabilities are determined in a new venture context.

5.4. A balance sheet is evaluated in terms of equity and / or financial net worth.

5.5. A balance sheet is drawn up for a new venture.

6. Make a financial decision based on financial statements.

6.1. Recommendations are made on how to improve the financial ratios of new ventures.

6.2. Ratios include profitability, liquidity, solvency and GP percentages.

6.3. The financial strengths and weaknesses of own venture are analysed in order to make suggestions to improve income and reduce costs.

Note that the following critical outcomes are also developed and assessed in an integrated manner, as part of this learning module:

1. Collecting
2. Communicating
3. Demonstrating
4. Identifying
5. Organising
6. Science
7. Working

Keep these learning goals in mind throughout your work related to this module.

There is an opportunity for self-assessment and a progress check at the end of this learner guide. Make time to assess yourself and ask the facilitator, assessor, your workplace mentor or coach for help if you are unsure of the answers.

Section 1: Business Administration Systems

Learning Goals and Pathways

In order to start operating a business effectively, you have to establish methodical and logical administration systems. Good administration and recordkeeping are cornerstones of a successful business.

This section will help you to examine and understand some of the typical management administration tasks and systems in business.

This section is presented in chapters 1 to 4 of the guide.

The learning goals for this module include:

1. Process payments.
2. Coordinate and monitor promotional activities.
3. Control and deal with confidential information and documents.
4. Implement control measures with individuals.

Chapter 1
Systems for Processing Payments

Cash Flow Management

definition

Cash flow

Incoming and outgoing cash, representing the operating activities of an organisation.

In accounting, cash flow is the difference in the amount of cash available at the beginning of a period (opening balance) and the amount at the end of that period (closing balance).

It is called positive if the closing balance is higher than the opening balance, otherwise, it is called negative.

Cash flow can be improved by:

- Selling more goods or services
- Selling an asset
- Reducing costs
- Increasing the selling price
- Collecting faster
- Paying slower
- Bringing in more equity
- Taking a loan

The level of cash flow is not necessarily a good measure of performance, and vice versa: high levels of cash flow do not necessarily mean high or even any profit and high levels of profit do not automatically translate into high or even positive cash flow.

In large companies management tasks such as financial management, administration, human resources, general management, operations, and research and development, may be handled by different people and, very often, by whole departments. However, an entrepreneur, on starting out a new venture, needs to fulfil all of these tasks (or ensure that they all get done).

One of the most important tasks in business is financial management. Funds should be flowing into the business regularly and money will need to be paid out regularly.

Payments to Suppliers

example

Examples of types of payments in an agribusiness

- Payments to suppliers for example fertilisers or other plant protection products
- Payments of salaries and wages to staff and casual labourers on a weekly and / or monthly basis
- Payments for overheads and expenses such as telephone bills or insurance

The management of financial resources must be done responsibly and diligently. If an entrepreneur manages his cash flow well, ensures that suppliers, staff (or casual labourers) and operating costs are paid on time, then he can build up a good reputation with creditors and financial institutions. A good credit history always stands one in good stead if you are seeking financial resources such as credit or loans. Ensure that, from the outset, you have enough funds to pay your regular costs.

There are several ways that you can process the payments of suppliers. Both ways are standard practice and have various advantages and disadvantages.

Option 1: Payment on Invoice

Pay the supplier immediately when an invoice is received.

The advantages of this method are:

- You do not run the risk of forgetting to pay later (due to a mislaid invoice).
- You will become known as a trustworthy client and the chances are good that the supplier will provide you with a better service, product or price if you choose to negotiate for such.

The disadvantages are:

- Keeping up with your payments, and doing them whenever the invoices arrive, may take time out of an otherwise busy schedule. You may want to only pay invoices once a week to reduce this constant paying of bits here and there when you would rather be concentrating on something else every other day of the week.
- You are not taking advantage of interest that you could be earning on the cash in your bank account.

Option 2: Monthly Payment Cycle

Pay each supplier within 30 days of the date of the invoice.

The advantages of this method of payment are:

- You can keep your cash in your bank account for a full 30 days earning interest without accruing any interest or penalties from your supplier.

The disadvantages are:

- You will need to keep meticulous records of when an invoice has reached its 30 days due date and pay before it expires. This requires careful bookkeeping and diligence.
- Even if you pay the invoice only one day late, you may accrue penalties or interest.

The method used is entirely up to the entrepreneur. Remember, however, that you should always check with the supplier or scrutinise the invoice to see whether you will be able to pay within 30 days, or whether the supplier may require COD – cash on delivery. As mentioned previously, a supplier that is paid promptly will be more open to negotiation for better prices, services, products, or credit in the future, if you are a reliable customer.

Payments to Staff

If your enterprise has grown to such an extent that you need staff or you need to use the services of casual labourers, you must realise that they are your MOST VALUABLE resource (aside from yourself!). The very fact that you have hired them means that you cannot manage all the tasks of your business yourself. You need them! Thus, you must look after them.

Firstly, ensure that you have complied with labour legislation as regards:

- Their health and safety at the workplace (providing them with the correct protective clothing, a safe and nurturing work environment).
- Adequate means to do their work (the correct space, the correct tools, and adequate skills).
- Providing them with written contracts of employment which clearly spells out their roles and responsibilities, the company policies, and their basic conditions of employment.
- Ensuring that their contracts stipulate the remuneration that they can expect, if any commission, bonuses, fringe benefits (vehicle or housing allowances, pension or provident fund) or dividends will be paid.
- Their annual leave, sick leave, maternity leave, family responsibility leave and study leave is clear.
- Ensuring that you have registered them for workmen's compensation, UIF (unemployment insurance), PAYE (pay as you earn tax), or SDL (skills development levy) as required.

Then you should ensure that you pay them what is their due on time. Some wages are paid when a task is complete, some wages are paid weekly and salaries are usually paid monthly. Whatever method you choose should be clear to your employees. You should also agree with your employees on the day of the month you will pay salaries. Sometimes salaries are paid in the middle of the month, sometimes towards the end of the month and sometimes on the last day of the month. It is good policy to discuss this with your employees so that everyone can provide inputs as to when it would be most convenient for everyone to be paid. This does not mean you should cater to everyone's whim and fancy. It means that some people may like to receive payment before the last day of every month (for the previous months' work) because their debit orders go off on the 1st and so on. General practice is to pay salaries on the second last or last day of every month.

When setting up the wages or salaries to be paid, keep in mind the following:

- The gross salary that the employee will receive.
- Whether there are any deductions that need to be made (such as telephone usage, tuck shop purchases, pay advances that must be repaid).
- Ensure that you deduct PAYE (if relevant).
- Deduct 1% UIF (your enterprise contributes a further 1% to the Unemployment Insurance Fund on your employee's behalf).
- Deduct the employee's pension fund or provident fund contribution (your enterprise contributes a matching amount to the pension or provident fund of your employee – this is usually in the order of 7% with an additional 7% contributed by your enterprise).
- Remember, you may only make deductions with the consent and knowledge of your employee. You may not make "forced" deductions that the employee does not agree to – such as taking a portion of the salary as a contribution to the end-of-year Christmas party. Obviously, deductions that are required by law must be made and the employee cannot disagree with this, but any other deductions can only be made with consent and his knowledge so that he knows what salary he can expect.

Pay the employee either in cash or through an electronic fund transfer (online banking). Every month or week (as relevant) the employee must receive a payslip which shows all the amounts discussed above. This payslip should also contain his / her name, the name of the employer, and if relevant his / her tax number and any other information required.

Payments for Operating Costs.

Every business has regular payments that must be made. These will include accounts such as water and lights, electricity, other municipal services such as refuse removal and sanitation, bank charges, fuel costs, telephone accounts and rental of equipment or buildings, bond repayments, or vehicle hire purchase payments. Many of these payments can be done through debit orders. However, mistakes can happen, and it is a very difficult situation if a supplier such as a Municipality, ESKOM or TELKOM makes a mistake and processes a debit order which is far in excess of your normal use. It often takes a lot of time and effort to have these charges refunded, and in the meanwhile, your cash flow is negatively affected, or you run up other penalties which are even more difficult to have removed from your record.

For a small business, it is often easier to process these payments manually, diligently and accurately. Unlike payments to suppliers, these types of payments must be paid within a week of receiving an invoice or statement of account. However, penalties may be charged (usually automatically) if you do not pay on time. These type of payments should be made as soon after receiving the account as possible. Very often if you pay only a week later, the amount will again show up as "unpaid" on your next statement of account and penalties could be charged. This also creates confusion for you when you next pay (if you do not keep accurate records of your past payments).

practical

Complete the following formative assessment:

F114805.1 – Team Analysis Questionnaire and Class Presentation

Chapter 2
Systems to Monitor Marketing and Promotional Activities

Drafting a Promotional Plan

A promotional plan outlines the promotional tools or tactics that are to be used to accomplish the marketing objectives. A promotional plan might be mistaken as the entire marketing plan because it outlines where the majority of the marketing budget will be spent. There are many components that are involved in promotional planning:

- Description (or listing) of the promotional tactics you are planning to use.
- Projected costs for the year.
- Explanation of how your promotion tactics will support your marketing objectives.
- Description of promotional adjustments for cyclical businesses, if yours is indeed cyclical.

Laying the Groundwork for Effective Promotional Tactics

When you are deciding on a promotional strategy for reaching your target market, it is very important to do adequate research, keep your customers in mind and be creative. Doing research includes activities such as studying your target market and finding out what other businesses in your industry are doing. A relatively quick way to learn how your competitors communicate their marketing message is by looking at local newspapers, relevant magazines or trade journals. This will give you an idea of which features they believe are important and which aspects of their service or product they are emphasising to their clients.

Keeping your customer in mind will help prevent you wasting your money and time on ineffective promotional activities. For example, it obviously will not help to advertise in a local newspaper if your target audience does not read it because it is not their language!

A major component of your promotion plan is the description of the planned promotional tactics you plan to use. There are many promotional tools and each one is easily the subject of an entire book. In fact, there are many good books available on the subject listed here. All sales promotion used must be in support of the selling strategy and your company image.

A partial list of promotional tools is listed here:

- Print advertising such as programmes for events, trade journals, magazines and newspapers
- Direct mail
- Outdoor advertising, such as billboards and bus boards
- Broadcast advertising on radio and TV (or internet sites)

Promotional activities may include:

- Sponsorships of special events (like fun runs or soccer matches)
- Participation in community projects
- Trade shows - your product or service might be one that is suited to exhibiting at a trade show attended by your target audience. Trade shows are typically one- or two-day events that allow businesses to set up exhibits or booths showcasing their products or capabilities
- Fairs (like health fairs, job fairs)
- Giveaways (like baseball caps and mugs with your logo)
- Coupons and free samples
- Conducting competitions
- Making speeches at conferences, professional association meetings and other events, positions you and your company as a leader in your field. Attending conferences is also an opportunity to make valuable contacts that lead to sales.

Identifying Resources Required for the Planned Promotion

Operating an effective promotional plan requires resources such as people, money and technology.

For example, you may require staff to promote your product or service at a trade show. These employees will need to be paid for their time, they may need transport to get to the event, and they will need materials for the exhibit. The exhibition materials may need to be printed, or you may want to rent a monitor on which to play a documentary about your product. This documentary will need to be produced. You may want to give free samples away at the tradeshow or demonstrate how the product works. For this, you will need supplies.

Everything that will be needed for each promotional event must be listed, procured and budgeted for.

You may also want to run promotional activities once or twice a year, seasonally or monthly. These details along with the resources required need to be listed in your promotional plan.

If you draw up your plan accurately you will have a better idea of the costs involved and this can assist you to cut back if required. If the budget is tight you can also be more discerning as to the activities you will undertake, by ensuring that you only undertake those activities that will give you the best return on your marketing investment.

Remember, for a small enterprise, you must make sure that your promotional activity will be more than adequately covered by the increased sales you will make as a result of the promotional activity!

Administrative Format for a Promotional Plan

Create a simple, practical plan that is easy to complete and which will give focus and direction to your marketing effort. The simpler the plan, the easier it is for you to monitor the results of your promotional strategy so that you can keep on improving it.

The ideal promotion plan is one that results in clear steps you can put into practice immediately. This means concentrating on just practical promotional aspects that will lead to results.

A simple promotion plan format:

- Define your target customers
- Define your marketing objectives
- Tactics
- Implementation
- Timeline
- Budget
- Evaluate

Define your Target Customers

This section of your plan describes the types of customers you want to sell to over the next year. These could be your existing customers or new customers.

- Existing customers who have spent over a certain amount (R 10,000-00 for instance) with you in the last year.
- Identify a certain type of customer you sell to at the moment, so that you can target a similar type of customer in a different town or city.
- Identify a certain type of person or business you already sell to, then ask yourself if there are any other types that might require what you sell.
- List any other groups of people or types of businesses that may be interested in what you sell.

The focus is on establishing as precisely as possible the targets you are going to spend most of your promotional efforts on in the coming year. It is not possible to market to everyone (this is both difficult and expensive, if not wasteful), so it is better to concentrate instead on the targets that you have listed. It is always easier to sell more to your existing customers than to people who have never bought from you before.

Sometimes it can be difficult to identify your target market. Refer to the SWOT analysis of your business (strengths, weaknesses, opportunities and threats) which will help you to focus on the marketing areas where you are most likely to reap benefits.

Define your Marketing Objectives

Your main business objective is to keep your customers happy and to get them to spend more of their money with you. Keep the objective simple and ensure that it is measurable. This way you can evaluate whether your promotional plan is working or not. This can be achieved by adding up the total sales from your targeted customers in the past year, and then seeing, at the end of the year, if you can increase sales to this target market by 30%. If you set your target in a measurable way like this, you can ensure that your promotional budget does not exceed this amount (In fact, your promotional budget must be less than this, otherwise you will not benefit from your promotional activities!).

Define Tactics to Reach your Objectives

It is important to write down what you are actually going to do to promote to each target.

- You may want to host a competition.
- You may want to promote your product at two trade shows.
- You may want to advertise weekly in the local press.
- You may want to print flyers and distribute them at a local soccer match where you have sponsored the t-shirts of the players.

Each of these activities must be budgeted, timed / scheduled and the resources required for each defined. Remember to keep within your budget and monitor the effectiveness of the activity. If you host a competition and sales after the competition does not improve, you may consider not doing this type of promotional activity again.

Implementation

After you have designed all the tactics you will employ you need to implement them. Have the flyers printed, have the documentary about your product produced, approach the local soccer team and offer to sponsor their t-shirts, organise the exhibition stand and design it.

Timeline

If you have scheduled your promotional activities in advance you will be able to ensure that everything that is required for each event is done in good time. The bookings are made, the soccer team gets their kit before the match, and the flyers are ready before the discounted sale.

Budget

Planning your promotional plan in this way will ensure that you can accurately assess the cost of your planned activities. Ensure that the cost does not exceed your planned increased sales or income objective (otherwise the exercise is fruitless and wasteful).

Too many businesses waste money on promotions because they have not taken the time to work out whether it is possible for them to recover the costs of the exercise. If your promotional exercises are not achieving the desired objective you may need to consider that the market might simply be too small or the business does not have sufficient capacity or time to do the extra work required. Your budgeting step is, therefore, a check on the practicality of the tactics you have decided to use.

Evaluate

Check regularly whether the plan is working. The increased sales that relate to your efforts must be assessed. This is quite easy in the examples we have used. For example, you can see whether there are increased sales following a competition, or an advert promoting a sale. You can assess how many sales you generated from the trade show you visited, or you can count the number of replies from a direct mail campaign. Another measure of success could be a reduction in complaints or returns received.

A well-considered promotional plan must be simple, practical and must be able to assist you to reach your increased income objectives. Planning in this way will assist you to improve your promotional performance in subsequent years, as you determine which tactics produce the best results.

Monitoring Promotions

Successful marketing must be directly correlated to improved sales revenue. Thus, to ensure that marketing is having the desired effect the promotional plan must be monitored continuously.

There are two issues that should be monitored.

Firstly, one must determine that you are keeping to the deadlines and activities as planned in the promotional plan. Are you keeping up with the collection of all the available resources, are you ordering the t-shirts or brochures on time, are you sending out the advertisement to the newspaper before the deadline? The plan will help you to keep to the deadlines you have set for yourself. Check the plan regularly to ensure that you are not missing an important event or deadline.

Secondly, you need to assess whether your promotional plan is having the desired effect or results. It is better to do this regularly (not only at the end of the year – when it may be too late to rectify matters). After each promotional event, an assessment should be made of how well the event met the increased revenue objectives.

Identifying Inadequacies and Corrective Actions

If one promotional event was more effective than another, determine why there was a difference and perhaps adapt your plan to change or replace the less effective method with a different tactic.

Remember, do not expect different results by doing the same thing over and over again!

practical

Complete the following formative assessment:

F114805.2 – Class Discussion and Team Document Framework Presentation

Chapter 3
Administration and Recordkeeping for Confidential Information

Confidential Information

Confidentiality is sometimes called secrecy or nondisclosure of information.

Information shared with only a few people, such as with an attorney for a legal matter, or with a doctor for treatment of a disease, is information perceived as confidential.

Why is Some Information Confidential?

It is simply because sensitive information is information or knowledge that might result in a loss for the company or its disclosure may lead to an advantage to others who might have low or unknown trustworthiness or hostile intentions towards the company.

Loss, misuse or unauthorised access to sensitive information can affect the privacy or welfare of an individual, of a business or even put the security of a company at risk.

The Law and Confidential Information

All companies have secrets. Some are technical such as the detailed specification of a manufacturing process. Some are business-related such as a list of customer names and addresses, which would be useful to a competitor. Some are of enormous value, for example, the recipe for Coca-Cola. Others are less valuable. Some are simple, even one word long, such as the name of a company takeover target. Others are complex, such as the details of a planned advertising campaign. The common factor is that all should be protected.

In recent years, many countries have introduced laws regarding the protection of confidential business information along the lines proposed by the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which states that for information to be legally protected:

- The information must be secret – not generally known or readily accessible to persons that normally deal with that kind of information.
- It must have commercial value because it is secret.
- The owner must have taken reasonable steps to keep it secret.

The most important thing is for the company / organisation to have a basic understanding and sensible internal rules so that their valuable information remains confidential.

An important factor in the protection of confidential information is proper management control. Managers should restrict access to secrets to the staff who need not know them. The biggest loss of confidential information from a company occurs when its staff leave and moves to another firm in the same area of business.

Also, it is important to mark documents with a word such as "confidential" if this is the case, but avoid the tempting mistake of marking every document, because such marking will have no real meaning and will be ignored.

Other security precautions may be needed, such as imposing password protections on access to information.

example

Trade secrets

Formulae, recipes, production methods, source codes, test results and other information obtained by research or other work or any confidential business information which provides an enterprise with a competitive edge may be considered a trade secret.

Business secrets

Budgets, customer lists, marketing plans and other information the release of which would be advantageous to a competitor and injurious to the company.

Personal information

Confidential, private, privileged, or proprietary information kept away from the attention, knowledge, or observation of others, and shared only with authorised, concerned, or trusted parties. This information can be kept as diaries, photographs, private information about public figures the disclosure of which could be profoundly embarrassing.

Professional information

An accountant or another professional advisor in the course of his or her professional duties.

Again it is important to note that different companies or organisations see different documents as important and that need to be regarded as confidential. So it would be wise to ask before you act on any company document.

The Risks of Information Theft

Things that can be done by people with information not belonging to them.

- A former employee providing confidential information to a new employer to aid dealings with the agency.
- An employee providing confidential information to a third party to gain an advantage when dealing with an agency.
- An employee leaking politically sensitive information to a member of the public or another stakeholder, such as the media.

Procedures for Dealing with Confidential Information

What might be regarded as being important and confidential in one company might not be in another. This is simply because companies are not working in the same business. Some are working with very confidential matters which must not be seen or read by the public, for instance, government departments. Others are working with information that can be seen by everyone.

Then there are common documents that are confidential in most businesses and companies, these include documents like:

- Salary payslips
- Company profits and spending
- Information the disclosure of which could harm the safety, success or efficiency of the company
- Matters relating to human resources (including personal affairs) affecting individuals

Confidential documents or information are kept in a safe and secure place in the company. These places are usually locked and the keys are kept by one person (for example the human resource manager or officer). This is done because if everyone in the company can have access to these documents some things can go missing and no one will know what happened.

Forms in which confidential information can be kept:

- Some companies prefer to keep information in hard copy, which means the information is kept in books or in files. These can be stored in store rooms and can last for years with all the information still intact if kept properly.
- Confidential information can also be kept on CDs and DVDs. These are very easy to use but information on them can be lost easily if they are not properly kept and they can be expensive.
- Computers are also another useful and modern way of storing confidential information. It is safe because computers usually have passwords which make it difficult for other people to have access to your information.

example

Example of a company's confidentiality agreement

Date: ____________________

Signed at: ____________________

Signature: ____________________

This document is intended to confirm for the record that the disclosure of any confidential information conveyed by the company to you (your name ______________________), to any other employee / representative of the company would be breaking the rules of the company or to anyone outside the company.

This letter also intends to inform you that if any confidential information is made public, the company has the right to take legal action against you.

This document furthermore aims to ensure that you will keep all confidential information confidential and that all orally conveyed information will be kept confidential. This includes:

- The company's financial situation
- The company's plans for new services
- The company's new products
- The company's proposed activities
- Other applicable discussions
- Employee's private information
- The company's assets

I (Name) _____________ (Surname) ______________ (ID number) ______________ hereby declare that all information disclosed to me by the company in confidence will be treated with the highest confidentiality and respect.

Signature of employer: ________________

Date: ________________

Signed at: _________________

Letters of this nature are designed and signed so that both parties, the employer and employee, know exactly what to expect if the contract is breached.

Consequences of breaching the contract are usually stated clearly so that no misunderstandings occur.

Risk Management Strategies

Here are some risk management strategies that should be considered by managers to help store and secure private information:

- Clearly defining and identifying what information is confidential and the extent of that confidentiality.
- Securely storing any documents containing confidential information.
- Tracking copies of documents containing confidential information.
- Implementing procedures for removing confidential information as soon as possible from laptops and other mobile computing devices.
- Implementing processes for protecting confidential information before engaging in any sharing arrangements with another organisation.
- Assigning overall responsibility for protecting confidential information to a senior employee.
- Maintaining, wherever possible, control over intellectual property rights.
- Releasing publicly available information promptly, reliably and cost effectively.

Computers, Fax Machines and Printers

- When possible, computers, fax machines and printers used for confidential data should be placed in secure areas where access is restricted to only those individuals with permission to access confidential information.
- Verify the correct fax numbers when sending confidential information, and always use a confidentiality cover sheet. If you receive an unintended fax that contains confidential information, immediately inform the sender and either secure or destroy the information.
- All faxes should state the confidential nature of the contents of the communication and have instructions should the fax be misdirected.

Computer Display

- Remove confidential data from screens where it is not required.
- Be aware of the position of computer screens. Unauthorised individuals should not be able to read screens containing confidential information. Use a monitor visor or hood in service areas.
- Be sure to log off from applications that show confidential data so that no data is accessible after you are finished.
- Computers that are used to access confidential information should have screen savers so that unauthorised people cannot read the information if they happen to wander into a restricted area.
- The use of a password protected monitor is highly recommended.
- Computers that are used to access confidential information or data should have a time-out feature so that when a staff person steps away from his or her computer for a period of time, the person is required to re-enter his or her password.

Passwords

- Computers that are used to access confidential data must be password protected.
- Employees should only be given access to those computers and information to which they are entitled.
- Passwords need to be kept confidential and need to be changed on a regular basis to ensure security.

Access

- Ensure that all keys and other items that allow access to confidential information, both physical access and computer access, are returned when the individual's access to the information is no longer appropriate.
- Do not look up confidential information pertaining to yourself or anyone else unless you are authorised to do so.
- Limit access to confidential information to the minimum needed to do the job.
- Implement electronic audit trail procedures to monitor who is accessing what.

Securing Confidential Records and Documents

Different employees may have access to different information within a company. These responsibilities should be clearly understood and implemented.

Computers

Passwords can be used to limit access to certain documents kept in computers.

Books

Although a very old fashioned way of keeping information confidential, books can last for very long periods if kept properly. They should be kept in safe places to avoid being seen by people who should not see them. These places should be locked and the keys assigned to a responsible employee.

Files and Papers

These serve the same purpose as books but one advantage of these is that information can be added or taken away as you wish. They should also be kept in a safe place, locked and the keys assigned to a responsible person.

Videos, Tape Recorders and Cell Phones

These are very useful tools because they are easy to handle and information on them can be accessed very easily. Information on them can be kept confidential because most of the devices have passwords to help keep information confidential.

To be able to keep these resources secure one should be able to answer the following questions:

- Where should this company information be kept?
- How should it be kept?
- Who is responsible for making sure that the resources are kept correctly?

People assigned the responsibility of working with confidential information should be people who are trusted and people who understand the consequences of a breach of confidentiality.

Points to Keep in Mind in Terms of Maintaining Confidentiality

For Employees

- The person in charge of keeping company documents confidential should make sure that these documents are kept safely at all times.
- If any letter or document in the company has "confidential" or "do not open" written on it, it is wise not to open and read that document.
- Do not open or read letters that are not addressed to you.

- Learn to be trustworthy.

For Employers

- All important documents must not be left lying around. They should be locked up safely.
- Keys to these places must be kept hidden or assigned to responsible individuals.
- If information is kept on computers, computers should have passwords so that not everyone has access to that information.

There are many ways in which documents can be stored for security reasons. All confidential documents must be locked in cabinets or desks. Things like memory sticks or CDs with documents that are sensitive must be stored in a locked file cabinet or desk. Disks with sensitive information must be locked in a cabinet with a non-standard key.

It is very important to protect the electronic records or documents with the confidential information, including backups, during storage by encrypting the files. Place the documents stored on a hard disk in a segment that is protected by an approved security programme requiring an access password.

Keys and access cards that permit entry into storage facilities where documents are stored must not be loaned or left where others could see them. Also, put labels on sensitive documents that state "Private" or "Confidential". Other documents that are in electronic format must be in .pdf format and must have a password to write or edit it. All documents must be secured from cleaning staff, maintenance staff and others who may have a need to access the facility where confidential documents are located.

practical

Complete the following formative assessment:

F114805.3 – Brainstorming Session and Mind Map with Key Notes

Chapter 4
Administering Employee Performance and Discipline

Implementing Control Measures

With both the payment of contractors, employees and overheads and the undertaking of promotional activities, confidential matters will arise. Only certain individuals within an organisation have the authority and / or responsibility to undertake these actions. This should be made clear to an individual through their employment contract and any further work instruction given to them through the course of their employment with your enterprise.

If a person is unclear as to their responsibilities and as regards the confidential material they have access to, then it will be very difficult to reprimand them if there is a security breach or the work is not done adequately. Not only should a person know what is expected of them, but the procedure that will be followed if they do not comply with what is expected of them should also be known. This information should be available in a company policy document.

Where a person knows what is expected of them, and they know what the consequences of not performing adequately are, then a disciplinary process, as described in the company policy manual, can be undertaken.

This may include a verbal warning, followed by a written warning, followed by a disciplinary hearing and finally dismissal, depending on the level of the transgression.

For example: If the cleaner does not clean the windows adequately and regularly it may be considered a minor offence. But, if that same cleaner allowed people into the building after hours to use the computers, that would be a more serious offence. If confidential information was then photocopied and sold to a competitor, which would be an offence that may result in dismissal.

Employees should also know that where they become aware of transgressions contrary to company policy, they should notify their superiors immediately.

Recording Non-Conformance and Negotiating Corrective Action

Where an employee has been found to be transgressing a company policy or not undertaking their work adequately, then the disciplinary procedure followed should be recorded and stored in their personnel file. This recordkeeping becomes important if the employee is a repeat offender and the business manager or entrepreneur wishes to implement a disciplinary process that may lead to dismissal. Not all transgressions will lead to dismissal but the process should allow for the employee to be able to mend their ways. This negotiation should be recorded in the employee’s personnel file.

Handling Non-Conformance

If a similar incident continues to occur the enterprise manager should check to see whether the policies regarding the problem are working adequately. The policy may need to be changed or adapted to ensure that the incidents do not continue.

In the case of security incidents, the system administrator and data custodian should be notified immediately of any known or suspected security breach involving confidential data so that corrective action can be taken.

practical

Complete the following formative assessment:

F114508.4 – Class Discussion and Role-play with Key Notes

Section 1: Self-Assessment and Progress Check

Process payments.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Payments to suppliers are processed within agreed timeframes and in accordance with company standards.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Payments to staff and casual labourers are processed within agreed timeframes and in accordance with company standards.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Payments for operating costs and rent are processed within agree on timeframes and in accordance with company standards.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Coordinate and monitor promotional activities.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Promotional plan or activities list is obtained and analysed.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Resources required for planned promotion are identified and obtained.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Promotional plan is put into place.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Promotion is monitored towards achievement of objective.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Inadequacies are identified and corrective action implemented.	❒ I have the answer and am	❒ I am still not sure of this and am

	ready to start with assessment	not ready to start assessment
Control and deal with confidential information and documents.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Confidential information is defined and described for a specific organisation.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
The system and procedures used for dealing with confidential information is explained with examples.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Documents are secured in an appropriate manner and within an agreed time frame.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Utmost care is taken to avoid compromising any relevant stakeholder.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Implement control measures with individuals.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Contracted control measures are implemented and non-conformances are identified for reporting to person with the authority to deal with them.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Non-conformances are recorded and corrective actions negotiated according to organisational requirements.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Reported non-conformances is handled in accordance with organisational policies and procedures and is duly recorded.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment

Section 2: Financial Management

Learning Goals and Pathways

Sound financial management is a key part of a successful business. Whilst financial management is preferably done by qualified and experienced bookkeepers and accountants, it remains imperative that you as entrepreneur know and understand the financial systems. With a clear understanding of the different elements and documents included in the financial system, you can ensure good cash flow and make sound financial and operational decisions.

This section will help you to work through the basics of financial systems, records and documents.

This section is presented in chapters 5 to 10 of the guide.

The learning goals for this module includes:

1. Explain financial aspects involved in running a new venture.
2. Apply cash flow management in the running of a new venture.
3. Apply an accounting system to manage a new venture.
4. Analyse an income and expenditure statement.
5. Analyse a balance sheet.
6. Make a financial decision based on financial statements.

Chapter 5
Financial Aspects of Business

Introduction

The role of a financial manager is to maintain an organisation's profitability, liquidity and solvency by providing the cash flow necessary to satisfy its obligations.

The financial manager is also responsible for managing a firm's current and fixed assets in conjunction with other functional departments such as marketing and purchasing.

Finance for non-financial managers provides an understanding of the principles of financial management and illustrates how they should be applied in order to create wealth and maximise profit. In order to do this well, it is important to know and understand some key financial terms and concepts, such as:

- The difference between start-up capital and working capital
- The relationship between cash flow and profit
- The difference between short-term finance and long-term debt finance
- The difference between fixed and working capital

The Difference between Start-up Capital and Working Capital

Start-up Capital

Any business requires some source of finance to start. Start-up capital refers to the total funds or money (own or borrowed) that is invested in a business to get it started. For a business to start operating it requires resources and inputs. The entrepreneur invests his capital in buying (or building) fixed assets and current or movable assets and also to obtain the initial stock in the case of a retail or product manufacturing enterprise.

Sources of Start-up Capital

Externally Generated

This capital is generated or obtained by either selling shares or borrowing money from a financial institution.

Internally Generated

This finance is obtained when a business generates profits and instead of distributing it to the shareholders, it is retained for future use in the business.

Working Capital

This is a financial term which represents operating liquidity available to a business, organisation, or other entity. Along with fixed assets such as plant and equipment, working capital is considered a part of operating capital. It is calculated as current assets minus current liabilities. If current assets are less than current liabilities, an entity has a working capital deficiency, also called a working capital deficit. Net working capital is working capital minus cash (which is a current asset) and minus interest-bearing liabilities such as short-term debt. It is a derivation of working capital that is commonly used in valuation techniques such as DCFs (discounted cash flows).

Working Capital = Current Assets – Current Liabilities

A company can be endowed with assets and profitability but short of liquidity if its assets cannot readily be converted into cash. Positive working capital is required to ensure that a firm is able to continue its operations and that it has sufficient funds to satisfy both maturing short-term debt and upcoming operational expenses. The management of working capital involves managing inventories, accounts receivable and payable and cash.

For a business with a published balance sheet, there are various ratios used to calculate a measure of liquidity. These include the following:

- The current ratio, which is the simplest measure and is calculated by dividing the total current assets by the total current liabilities. A value of over 100% is normal in a non-banking corporation. However, some current assets are more difficult to sell at full value in a hurry.
- The quick ratio (calculated by deducting inventories and prepayments from current assets and then dividing by current liabilities) gives a measure of the ability to meet current liabilities from assets that can be readily sold. A better way for a trading corporation to meet liabilities is from cash flow, rather than through asset sales.
- The operating cash flow ratio can be calculated by dividing the operating cash flow by current liabilities. This indicates the ability to service current debt from current income, rather than through asset sales.

It is clear that any business needs capital to start operating. The source of that capital may depend on the type of business that is being established or operated, for example, a community project may be funded by:

- District or local municipalities and provincial government departments
- Individual donors (philanthropists)
- Private companies (Corporate Social Investment – CSI)
- Foreign donors (such as the USAID – United States Agency for International Development, BFID - British Fund for International Development),
- NGO’s (Non-government organisations such as Heifer Project International or Farm Africa)
- Khula Land Reform Empowerment Facility
- Business Development Services Voucher Programme: this type of funding is used to pay for start-up business services such as branding and design of business forms, business and financial administration, legal services, a website for marketing purposes, due diligence, tendering support. These vouchers can be available from Umsobomvu Youth Fund (National Youth Fund) and the Small Enterprise Development Agency (SEDA).

- Banks: Loans can be accessed from banks such as FNB, Nedbank, ABSA, Capitec, Standard Bank, and others. Banks will feel more comfortable lending you money if you have a proven business concept.
- Grants from donor organisations or government are a gift of money that is given to an organisation with certain conditions.

Money received from donor partners or lending institutions is usually tied up to a contract. It is very important that your company plays a part in drawing up the contract so that the terms contained in the contract are in accordance with the aims and objectives of your organisation. Funds from a donor partner may be transferred directly into your account or may be sent as a cheque.

An individual's money can also be used as capital to start a business.

In starting a business, capital is invested in such things as buying the site, construction of appropriate infrastructure, buying the necessary inputs, equipment, and to start paying the labour.

The Link between Cash Flow and Profit

Cash Flow

This is one of the most important aspects of the financial management of a business. Cash flow should not be confused with profit because they are different concepts. Cash flow shows the money that:

- Flows into a business from sales, interest, payment received, and any borrowings
- Flows out of the business such as wages, rent, interest owing, paying back loans, buying raw materials.

Cash flow provides an approach to measuring inputs and outputs. If the amount of cash flowing into the business does not meet and exceed the cash flowing out of the business, eventually the business will be unable to meet its debts and can eventually lead to business failure. The biggest cause of business failure (especially new business) is caused by poor cash flow meaning that more money is flowing out of the business than flowing in. One should note that these businesses can be producing or supplying excellent products or services, but due to poor cash flow management they result in failure.

Profit

Is calculated by taking the turnover and subtracting from it the cost of sales, which are the direct costs, and you will get the gross profit. From the gross profit, we subtract the overhead costs (which are indirect costs) to arrive at the net profit.

example

Turnover (Sales Revenue)

Minus (subtract)	**Cost of Sales**
Equals	**Gross Profit**
Minus (subtract)	**Overheads**
Equals	**Net Profit**

The one thing to note about the figures that go towards these totals is that they are extracted from the company books, ledgers and journals where all the business transactions are recorded (both payments and receipts). In simple terms, profit is total receipts less total costs.

Profits can be used in the following ways:

- To pay taxes.
- To pay the directors (investors or shareholders) as a reward for their investment. This is called dividends or drawings.
- Can be retained in the business as a source of renewed investment (capital to expand the business).

Cash flow is the movement of cash into or out of a business, project, or financial product. It is usually measured during a specified, finite period of time. Measurement of cash flow can be used to determine an enterprise's rate of return or value. The timing of cash flowing into and out of an enterprise is used as inputs in financial models such as internal rate of return, and net present value to determine problems with a business's liquidity. Being profitable does not necessarily mean being liquid. A company can fail because of a shortage of cash, even while profitable.

Cash flow is a generic term used differently depending on the context. It may be defined by users for their own purposes. It can refer to actual past flows, or to projected future flows (as is done in business planning).

Statement of Cash Flow in a Business's Financials

The (total) net cash flow of a company over a period (typically a quarter or a full year) is equal to the change in cash balance over this period: Positive if the cash balance increases (more cash becomes available), negative if the cash balance decreases. The total net cash flow is the sum of cash flows that are classified in three areas:

- Operational cash flow: Cash received or expended as a result of the company's internal business activities. It includes cash earnings plus changes to working capital. Over the medium term, this must be net positive if the company is to remain solvent.
- Investment cash flow: Cash received from the sale of long-life assets, or spent on capital expenditure (investments, acquisitions and long-life assets).

- Financing cash flow: Cash received from the issue of debt and equity, or paid out as dividends, share repurchases or debt repayments.

How Cash Flow relates to Profit

The following points illustrate how cash flow relates to profit:

- The amounts of cash flows during the period are rarely equal to the revenue and expense numbers in the P&L (profit and loss) report for the period.
- Actions that lower cash flow: increasing accounts receivable and inventory, decreasing accounts payable and accrued expenses payable.
- Actions that raise cash flow: decreasing accounts receivable and inventory, increasing accounts payable and accrued expenses payable.
- Depreciation expense is not a cash outlay in the period recorded, neither is amortisation expense.
- Unusual losses recorded in the period may not involve cash outlay but rather be write-downs of assets or write-ups of liabilities.

Short-term vs. Long-term Finance

Sources of financing for a business can be categorised into long-term, medium-term and short-term.

Long-term Financing

This type of financing for a business extends for a period of more than ten years. This type of financing comes from sources such as owner's equity and long-term loans. The owner's equity is the first source of capital for the enterprise, in other words, the capital invested by the sole owner or partners of the business.

Medium-term Sources of Financing

This type of financing is usually for a period of approximately five years. The medium-term loans have the same characteristics as long-term loans. Sources of medium-term loans are term loans, financial leasing and hire-purchase transactions. This type of financing can be used for financing of assets, additional operating capital and financing of band overdraft if the limit has been exceeded and needs to be paid.

Short-term Financing

A short-term loan usually extends for a period of one year. However, depending on the actual financing, it may extend slightly over a year. Examples of such financing may include bank overdrafts, short-term loans, buyer's credit and supplier credit. The use of short-term financing in a business may be financing a portion of the operating capital, seasonal fluctuations, bridging finance (payment for things such as bank overdrafts) and purchase of smaller fixed assets.

Short-term financing can be accessed through various means such as:

- Overdraft facilities: this is a form of a bank loan where the bank allows a company to overdraw up to an agreed limit.

- Trade credit: this is where the companies from which you buy your inputs, raw materials and goods extend credit to you.
- Factoring: if a company has slow payers of their debt, they hand them over to a collection agency which collects the debt and retains 10% of the debt collected.

The capital needs of a business may also be differentiated into permanent and seasonal needs, thus, competency in financial planning is needed to manage such needs.

- Permanent financial needs consist of fixed assets.
- Seasonal financial needs consist of temporary current assets which fluctuate during the year.

An example of these is shown in the table below.

example

ESTIMATED NEED FOR FUNDS FOR MAHLANGU FRUIT MARKET IN 2017

	Current assets	**Fixed assets**	**Total assets**	**Permanent need for funds**	**Seasonal need for funds**
MONTH	**(1)**	**(2)**	**(1) + (2) = 3**	**(4)**	**(3) – (4)**
	R	**R**	**R**	**R**	**R**
January	5000	15000	20000	15500	4500
February	2500	15000	17500	15500	2000
March	200	15000	15200	15500	-300
April	1500	15000	16500	15500	1000
May	500	15000	15500	15500	0
June	1000	15000	16000	15500	500
July	4000	15000	19000	15500	3500
August	2500	15000	17500	15500	2000
September	3400	15000	18400	15500	2900
October	5000	15000	20000	15500	4500
November	4500	15000	19500	15500	4000

December	3000	15000	18000	15500	2500

The table above is an example of the estimated capital needs for Mahlangu Fruit Market which indicates the needs of capital in a business for current assets, fixed assets and total assets. It can be seen that total assets are a combination of both current and fixed assets, and the seasonal needs for capital are total assets minus permanent needs for funds. The purpose of this table is to plan adequately so that one understands the needs of funds in a business. Do you see that the fixed assets of Mahlangu Fruit Market do not change over the year?

Your organisation will need to purchase furniture and equipment from time to time. In accounting terms, these are referred to as fixed assets. Fixed assets are items that we acquire for use in the operation of our organisation.

They are not intended for resale. Fixed assets are purchased in order to assist us with our work and they are normally kept for longer than one year.

There are five categories of fixed assets that your organisation may purchase:

- Furniture
- Equipment
- Motor vehicles
- Land and
- Buildings

The decision to purchase fixed assets is a major decision. Fixed assets are usually expensive items and therefore the Board should authorise a fixed assets purchase.

Fixed assets need to be looked after carefully. We need to know the following information about the fixed assets that have been purchased:

- Exactly what items have been purchased
- Who it was purchased from
- When it was purchased
- How much was paid
- Where each item is located

In order to keep proper control over fixed assets, it is vital that the organisation keep a fixed assets register. Your fixed assets register could be a file with different sheets for each fixed asset, or it could be a book with a different page for each fixed asset.

As soon as an asset has been purchased and entered into the fixed assets register, a sticker with a number allocated to the asset should be stuck onto the asset, or the number should be written on the asset with a permanent pen.

Fixed and Working Capital

Working Capital (Net Working)

This refers to the operating liquidity available to a business. Although the company will have its fixed assets such as offices, building, land, plant and equipment, along with these there will be the working capital which is considered a part of operating capital. To calculate the working capital for one's business, you subtract your current liabilities from your current assets. If your answer shows that your current liabilities are more, then your company has a working capital deficiency or working capital deficit.

Working Capital = Current Assets – Current Liabilities

Current Assets

In accounting, a current asset is an asset on the balance sheet which is expected to be sold or otherwise used up in the near future, usually within one year or one operating cycle, whichever is longer. Typical current assets include cash, cash equivalents, accounts receivable, inventory, the portion of prepaid accounts which will be used within a year, and short-term investments.

Current Liabilities

Current liabilities are considered liabilities of the business that are to be settled in cash within the fiscal year or the operating cycle, whichever period is longer. An operating cycle is the average time that is required to go from cash to cash in producing revenues. For example, accounts payable for goods, services or supplies that were purchased for use in the operation of the business and payable within a normal period of time would be current liabilities.

Bonds, mortgages and loans that are payable over a term exceeding one year would be fixed liabilities or long-term liabilities. However, the payments due on the long-term loans in the current fiscal year could be considered current liabilities if the amounts were material.

The proper classification of liabilities is essential when considering a true picture of an organisation's financial health. The following points should be noted regarding the working capital of your business:

- A company can experience working capital deficit regardless of whether it owns assets and is profitable, meaning that there is no liquidity of assets that can be readily converted into cash.
- With sufficient working capital, a company is able to take care of the short-term debt and upcoming operational expenses.
- To ensure that the company always has sufficient working capital, you need to manage inventories, accounts receivables and payment of cash.

Fixed Capital

Refers to any kind of real or physical capital or fixed assets of a company that are not used up during the production process. Fixed capital is the portion of the total capital that is invested in assets such as land, buildings and vehicles which will stay with the business permanently.

Factors that Influence Fixed-capital Requirements

- The nature of the business: the nature of the business certainly plays a role in determining fixed capital requirements. For example, a florist needs less fixed capital than a car manufacturing factory.
- The size of the business: the bigger the business, the higher the need for fixed capital.
- The stage of development of the business: the requirement of capital for a new business is usually greater than needed for an estimated business that has reached optimum size or optimum size.
- It refers to any kind of real or physical capital (fixed asset) that is not used up in the production of a product and is contrasted with circulating capital such as raw materials, operating expenses and the like. Fixed capital is that portion of the total capital that is invested in fixed assets (such as land, buildings, vehicles and equipment) that stay in the business almost permanently, or at the very least, for more than one accounting period. Fixed assets can be purchased by a business, in which case the business owns them, but also leased, hired or rented, if that is cheaper or more convenient, or if owning the fixed assets is practically impossible.

Fixed capital also "circulates", except that the circulation time is much longer, because a fixed asset may be held for five, ten or twenty years before it has yielded its value and is discarded for its salvage value. A fixed asset may also be resold and reused, which often happens with vehicles.

Estimating the Value of Fixed Capital

Attempts have been made to estimate the value of the stock of fixed capital for the whole economy using direct enterprise surveys of "book value", administrative business records, tax assessments and data on the gross fixed capital formation, price inflation and depreciation schedules.

Using the so-called "perpetual inventory method", one starts off with a benchmark asset figure, and adds on the net additions to fixed assets year by year, while deducting annual depreciation, all data being adjusted for price inflation using a capital expenditure price index. In this way, one obtains a time series of annual fixed capital stocks.

However, it is widely acknowledged that it is extremely difficult to obtain any accurate measurement of the value of fixed capital, especially because even the owner himself or herself may not know what assets are currently "worth". Some valuations for fixed assets may refer to historic cost (acquisition cost) or book value, others to current replacement cost, current sale value in the market, or scrap value. The depreciation write-off permitted for tax purposes may also diverge from so-called "economic depreciation" or "real" depreciation rates. Economic depreciation rates are calculated on the basis of the observed average market prices that depreciated assets at different ages actually sell for. Sometimes statisticians try to estimate the average "service lives" of fixed assets as a basis for calculating depreciation and scrap values, based on the observed length of time that fixed assets are actually held and used by their owners.

Investment Risk of Fixed Capital

A business executive who invests in or accumulates fixed capital is tying up money in a fixed asset, hoping to make a future profit. Thus, such an investment usually implies a risk. Sometimes depreciation write-offs are also viewed partly as a compensation for this risk. Often leasing or renting a fixed asset (such as a vehicle) rather than buying it is preferred by enterprises because the cost of using it is lowered thereby, and the real owner may be able to obtain special tax advantages.

Sources of Funding for Fixed Capital Investment

An owner can obtain funding for the purchase of fixed capital assets from the aptly-named capital market, where loans are given on a long-term basis. Funding can also come from reserve funds, the selling of shares, and the issuing of debentures, bonds or other promissory notes.

practical

Complete the following formative assessment:

F263474.1 – Paired Research Worksheet

Chapter 6
Cash Flow Management

The Importance of Cash Flow Management

Cash flow management involves specific tasks, tools, methods and time frames that should be clearly understood and then applied and followed effectively by a business owner. These activities include:

1. Bookkeeping
2. Budgeting and managing budgets
3. Debt and credit collections
4. Managing inflow of money (part of cash flow)
5. Monitoring your costs (part of cash flow)
6. Managing your bank account

Developing and Using a Cash Flow Budget as a Financial Management Tool to help with Cash Flow Forecasting

When developing a cash flow budget, the following step-by-step process will guide you through the preparation of a cash flow projection:

Step 1: Cash on Hand

Count your cash at the beginning of the first month of your projection. This amount is your "cash on hand." In succeeding months, the ending cash balance from one month will be carried over as the beginning cash balance of the next month.

Step 2: Cash Receipts

Record cash sales, credit card sales, collections from credit accounts, and any interest income. The key to doing this successfully is recording receipts in the months you actually expect to get the money, not the month a sale is made.

Step 3: Accounts Receivable

Record anticipated receivables in the months you expect them to be paid. If you have not kept records that show you how long it takes individual customers to pay their bills, calculate your "average collection period" by dividing your total sales for the previous year by 365. That gives you your average daily sales volume. Then, divide the Rand value of your current accounts receivable by the average daily sales volume. That number is the average number of days it takes you to collect on a bill. Using that number as a guide, record payments as they come in over the next year.

Step 4: Miscellaneous Cash

Account for anticipated miscellaneous cash infusions, including new loans from banks or family members, or stock offerings.

Step 5: Total Cash Available

For each month in your projection, add the amounts in steps one through four. This figure shows the total cash available to you in each month.

Step 6: Cash Paid Out

Now it is time to calculate how much cash you anticipate spending in each month of your rolling projection.

First, assess operating expenses. Again, the secret is to note every expense in the month it will be paid, not the month it is incurred. Be sure to include the following items in your list of operating expenses:

- Gross wages, including anticipated overtime
- Monthly stipends / salaries to owners
- Payroll taxes and benefits, including paid vacations, paid sick leave, health insurance and unemployment insurance
- Subcontracting and outside services, including the cost of labour and materials
- Purchases of materials for use in making your product or service, or for resale
- Supplies for use in the business
- Repairs and maintenance (be sure to include occasional large expenses for remodelling, renovation)
- Packaging, promotion, marketing and delivery costs
- Travel and car costs
- Advertising and promotion, including fliers, direct mail, print or TV ads, yellow pages listings, website maintenance and design
- Professional services such fees paid to attorneys, bookkeepers, accountants and consultants
- Rent
- Telecommunications such as phone, fax and internet service provider
- Utilities such as water, heat and electricity
- Insurance including fire, liability and workers' compensation
- Taxes
- Interest due on loans
- Other expenses focusing on costs specific to your business
- Miscellaneous (include a small cushion for miscellaneous expenditures)

When you are finished recording these, subtotal your operating expenses.

Step 7: Other Costs

Calculate the other ongoing costs of doing business. Be sure to include the following items:

- Loan principal payments – vehicles and equipment purchases
- Capital expenditures - depreciable expenditures such as equipment, vehicles, construction of new or improvements to existing buildings and improvements to leased facilities and offices
- Start-up costs - expenses incurred prior to the first month of operation and paid for over the course of the following year(s)
- Reserve or escrow - money set aside monthly for taxes paid at the end of the year, plus any money escrowed to help make payments on large insurance or machinery bills
- Owner's withdrawal - payment of owner's income tax, health and executive life insurance

Step 8: Total Cash Paid Out

Once you have listed all other costs of doing business, add them to your subtotal for operating expenses. This figure is your "total cash paid out" and reflects your estimates for the total cash you will have to spend each month.

Step 9: Determine your Monthly Cash Flow

Subtract your total cash paid out (Step 8) from your total cash available (Step 5). The difference is your monthly cash position or cash flow. As you plot your projected cash flow, check to be sure your cash position at the end of each month is positive. If it is not, take steps early to cover these anticipated shortfalls.

Update your cash flow projection monthly, making adjustments whenever you encounter an unexpected expense or income. As actual sales and disbursements are made, list the actual amounts next to the estimates on your cash flow projection. Check for accuracy in your forecast, and make adjustments to future months as needed. As one month ends, add another month to the end of your rolling projection.

As discussed above, it is clear that one of the main limiting factors in all different organisations; particularly in small business is cash flow. If cash is lacking or mismanaged it is a common cause of business failure. A cash flow (historic and future) becomes a useful tool in managing cash in a business.

There are certain principles that must be kept in mind when managing the cash flow of a business:

- Your goals (financial goals) as an entrepreneur
- Products sold or services offered
- Creating or maintaining favourable working conditions or the employee in your business
- Creating and maintaining a cordial relationship with the suppliers of your business
- Creating and maintaining a good relationship with your customers

- Creating and managing a healthy business cash flow

Step 10: Determine your Monthly Surplus or Shortfall

For a specific month, this can be calculated by deducting total expenditure from total income. The sum total of the surplus / shortfall and the opening bank balance gives the new balance, which could be positive or negative. If the balance is negative, the interest applicable to the business's bank overdraft is added to calculate the closing balance. In the case of a positive balance, the amount is directly carried over to the closing balance, because no interest is payable in this case. It should be borne in mind that interest is calculated monthly only on overdrawn balances. The closing balance for one month is the opening balance for the following month.

Cash Flow Forecast

A cash flow projection or budget or forecast is a plan for the future. It is a statement of resources matched to intentions, a practical agenda for action. A cash flow forecast clearly shows how the money will be spent on the business and how the income will be generated by the business.

Budgeting is important because:

- It sets out the targets to be achieved
- It defines the activities that are necessary to achieve these targets
- It sets out estimates of the required resources

In building a budget, managers should take account of:

- The purpose of the organisation
- Their own specific targets
- The views of other managers
- The interaction and interdependence between sections of the organisation
- The past and the future
- The financial and other resources

Creating a Cash Flow Forecast

The key skill in cash flow management is forecasting and managing company cash flow. Few business owners use financial forecasting to identify potential financial issues that can impact earnings. Once learned, forecasting can help small business owners smooth out the regular ups and downs that all companies experience as a normal course of business. In fact, the firm's financial statements and the forecast of future revenues and expenses are some of the most valuable management tools that small business owners have at their disposal.

There are several types of financial forecasts that an owner may need to prepare. The purpose of all of them is to show a realistic picture of the firm's future cash flow. One type of cash flow forecast is that required by prospective lenders. Creditors will look at and stress a company's financials and cash flow forecast to determine if a business will be able to cover principal and interest payments during the life of a loan. Stressing the cash flows means looking at scenarios where income and expenses are negatively impacted, to determine if the company can still fulfil its obligations in tough economic times.

There are 5 steps in creating a cash flow forecast:

Step 1: Prepare a List of Assumptions

Forecasts are driven by assumptions and therefore for the forecast to be useful the underlying assumptions must be appropriate to the business.

Assumptions can be based on past performance, industry publications, correspondence from customers and suppliers, and generally include:

- Timing and quantum of price increases – both yours and your suppliers'
- Sales growth estimates
- Impact of seasonality
- Provision for general cost increases (CPI)
- Provision for internal salary and wage increases

Listing the assumptions within the forecast adds credibility and serves as a reminder when assessing actual performance against forecast.

Step 2: Prepare Anticipated Sales Income

Sales can be difficult to predict, and often the best place to start is to look at sales in previous years to identify trends. You can then identify internal (for example price increases) and external (for example economic) factors likely to impact the current period, and make necessary adjustments.

When you have determined realistic sales for the period, they need to be broken down into sales receipts (i.e. When is the cash expected to be collected from debtors?). There is often a pattern to debtor remittance (for example 60% within terms, 25% one month outside terms with the remainder coming in shortly thereafter). Note: this pattern should form one of the forecast's underlying assumptions.

Step 3: Prepare a List of 'Other' Estimated Cash Inflows

To ensure your cash flow forecast is complete, compile a list of all other anticipated cash inflows, for example:

- Tax refunds
- Insurance proceeds
- Additional equity contributions or loan proceeds
- Government grants receipts
- Cash from asset divestment
- Royalties or franchise / license fees

Step 4: Prepare a List of Estimated Expenses

These should include direct and indirect expenses. The key is identifying all the expenses required to operate the business and anticipating the timing of each payment. Cash outflows relating to financing and investing activities should be included, for example:

- Payments to suppliers
- Wages and salaries of all staff
- Purchase of new assets
- Loan repayments
- Director drawings

Bank statements are an easy way of identifying direct debit arrangements.

Step 5: Putting the Information Together

Simply put, a cash flow forecast is a rolling calculation based an opening cash position, adding cash inflows and deducting cash outflows, to arrive at a closing cash position.

information

Projection notes

When making projections of items in the cash flow budget, take note of the following:

Income - Sales

Income from sales is the most important source of income and the most difficult to estimate. Two of the things you should bear in mind when trying to estimate your monthly sales figures are the age of your business and seasonal variations. If you are a new business you will need time to build up your trade. Your sales forecast should reflect this. It is advisable to begin with low monthly figures. Be conservative and realistic. You should separate cash sales and cash from debtors.

Stock And Raw Materials

The stock figure should include initial stock purchases and the subsequent replenishment of stock. The stock figure should bear a direct relationship to the sales figures in other words if you buy an item for R25 and intend to sell it for R50. Then the stock should represent 50% of sales. A distinction needs to be made between your cash purchases and your credit purchases.

Capital Equipment

Make a list of all the equipment required to run your business then obtain prices for all items. Establish what you need to obtain at the outset and what could be bought later on in the year then budget accordingly. Consider the options of obtaining these items by outright purchase, hire purchase, leasing. One advantage of hire purchase and leasing is that the cost can be spread over a specified period and this can aid your cash flow. The interest incurred has to be considered.

Vehicle Costs

When estimating your vehicle cost include not only the actual cost of the vehicle, (if on hire, purchased or leased) but also all the other costs for example road tax, insurance, repairs, renewals, petrol. If purchased outright, see 'capital allowances' under taxation.

Opening Balance

This shows how much should be in your business bank account at the start of the month. When starting up you should put the figure of available funding or capital into the cash flow as its opening balance.

Closing Balance

Work out the closing balance for the month by adding any opening bank balance to the total receipts and deducting from this the total payments figure. The closing bank balance becomes the opening bank balance automatically at the start of the next month.

The closing balance figure for each month is very important. If it is a minus figure it means you may have to make use of an overdraft facility or plan a sales drive for the months preceding it to avoid "going into the red". The cumulative figure tells you whether your bank balance gets bigger or smaller over a period of time and highlights the duration of any borrowing requirements.

Using a Cash Flow Forecast to make Decisions

A cash flow forecast is a vital management tool that encourages you to plan ahead and then helps you to make important strategic decisions about the operation of your business. A cash flow forecast shows how and when you expect money to be received and paid out by your business. Cash is the lifeblood of any business and it is, therefore, vital to know that your business will have enough cash to pay its creditors and expenses when they fall due. A cash flow forecast is usually projected over a period of six months or twelve months, although you can look at a shorter period such as a week, a month if it necessary. The forecast can then as a management decision-making tool that allows you to identify:

- How much initial cash investment a start-up business requires
- When other finance, such as an overdraft or a loan, may be needed
- What level of loan repayments you can afford
- When your business will be able to spend cash in the future, such as:
  - Taking on a new employee
  - Paying for a marketing campaign
  - Purchase of capital equipment
- How much cash your business will be able to pay you
- When cash flow problems may occur once your business is trading and as it grows

Cash flow forecasts also provide details of the income that the business receives in the form of receipts. The income from cash sales is received immediately, whereas with the credit sales there will be a delay in receiving the money depending on the credit period that has been agreed with your customers. If we assume that all customers will pay within 30 days, the money from credit sales invoiced in January will be received in February. If your business is registered for Value Added Tax (VAT), the VAT charged on your sales and paid by your customers should be included in the receipts.

Interpreting Bank Statements for Cash Book Reconciliation

The bank statement is a handy way of seeing all your incomings and your outgoings at once. It is definitely a good idea to open and read your bank statements so you can check if you have received what you expected, and that you recognise all the payments going out too. This will help you to understand how to read and make sense of your bank statement.

Your bank statement might be sent monthly, quarterly or yearly, depending on what type of account you have. Example on the table below for simple explanation.

Type of account	**Frequency of statements**	**Reason**
Current	Every month	Money going in and out regularly – wages and everyday spending
Savings	Every three months (quarterly), or every year	Not many payments out

You will get your statement through the post, but if you bank online, you can also access it on the internet, and possibly opt out of receiving paper statements.

Your statement will show all the money in and out for your account during the set period (monthly or otherwise).

The details will include the date, amount and an identifier for the payment (such as a shop name for purchases). For benefits, the identifier could be the Department of Social Welfare, SASSA or your local council if it is housing benefit.

example

Bank Statement

YourDosh Bank
16 High Street, Anytown, Anyshire YZ99 1XY

1

Mr John Smith
5 Any Road
Randomford
Anyshire
YZ98 5XY

Account name: **Mr John Smith**
Sort code: **53-61-33**
Account number: **99988877**

Your current account statement:
1 February to 1 March 2011

Page 1 of 1

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3

Your account summary

Balance at 1 February: £312.34
Total money in: £300.00
Total money out: £343.02
Balance at 1 March: £30.68 OD

4

Date	Description	Money out	Money in	Balance
	Balance brought forward			**312.34**
1 February	Card payment – High St Petrol Station	24.50		287.84
	Direct debit – Green Mobile Phone Bill	20.00		267.84
3 February	Cash withdrawal – YourDosh, Anytown High Street, timed 17:30 31 Jan	30.00		237.84
8 February	Cheque 00068	22.95		214.89
11 February	BACS – KleanKars, ref JS5-999		300.00	514.89
16 February	Standing order – Rent to J Jones Cash withdrawal – WadBank, Randomford, timed 09.52 14 Feb	300.00		214.89
17 February	Card Payment – High St Petrol Station	40.00		67.14
	Direct debit – Home Insurance	23.00		44.14
19 February	Online transfer to A/C 1116932, Sort 01-92-10 ref: Mum	34.14		10.00
21 February	Card payment - QuidsGifts	15.00		5.00 OD
24 February	Balance carried forward			5.68 OD
28 February	Card payment - QuidsGifts	25.00		30.68 OD
1 March	Interest 29 Jan A/C 99988877	00.68		30.68 OD
	Charges 29 Jan A/C 99988877	25.00		30.68 OD
	Balance carried forward			**30.68 OD**

5

6

Explanation of Contents of a Bank Statement

1. Your personal information

This is your name and permanent home address. Make sure that it is right, and that you have not got someone else's bank statement! It is important to tell your bank if you move or relocate, so they can safely and securely send any information about your account to you.

2. Your account information

This will show the name you used to open your account with (account name), such as "Mr John Smith". It will also show your account number and sort code. Your sort code is a six-digit number with dashes in (for example, 53-61-33) that helps the whole banking system identify which bank and local branch your account is based at.

3. Statement summary

You will be shown a basic account summary, which will usually show the total amounts paid in and out during that month (or another period if it is a savings account). You can also see here that there is a closing balance. This means the balance of your account at the time the statement was sent out.

4. Monthly incomings and outgoings

On your statement, there will be two columns showing money paid into your account (credits) and one for money paid out (debits). Your statement will be ordered by date, so it will show the oldest payments at the top, working down to the most recent. Next to each payment is also a description, which shows where you were when you made the payment (a shop or cash machine) or who you paid. There might also be standing orders or direct debits you have arranged. This information should also be available for the "money in" section – it might say "bank transfer" for your wages, "counter credit" for cash or cheques you have paid in at your branch, refunds from shops, or automated payments made by the state to you, such as benefits.

Sometimes payments will show up on your statement a few days after you actually made them. For example, if you buy something with your debit card in a shop (or withdraw cash from a machine), it might not show up on your statement for a few days. This is because it takes time for payments to go through the banking system, especially over a weekend. When this happens, the actual date you made the purchase or cash withdrawal should be shown in the description column.

In the far right column, you can see a running total, the balance. This means the total you have in your account each day, as a result of money in and out of your account.

5. Going overdrawn

In your balance column, sometimes you will see the letters OD or a minus sign next to the figure. This means your account is overdrawn and you have spent more money than you had in your account. So, if you had R 10 in your account, but buy something on your debit card for R 15, you will go overdrawn by R5 (R 10-R 15 = -R 5). You will have to pay this back to the bank, along with any interest and charges unless you have an interest-free overdraft. The longer you delay paying back your overdraft, the longer you will be charged interest on it, and the harder you may find it to get out of your overdraft.

That is why it is really important not to become reliant on your overdraft. It costs you more money in the long-term to borrow from the bank like this. It is a good idea to do all you can to stay in "the black" (plus numbers) and get out of "the red" (minus numbers). It could be a spiral into debt, so make sure you are not always right at the limit of your overdraft.

6. Bank charges

If your account is overdrawn beyond your agreed limit, or you did not have an agreed overdraft, the bank will charge you for "unarranged borrowing". They can also charge you if you pay in a cheque that bounces (that is when the other person does not have enough in their account to cover the amount they wrote the cheque for). Banks have to notify you before they take any money from your account for these charges.

practical

Complete the following formative assessment:

F263474.2 – Team Work Sample Presentation

Chapter 7
Accounting Systems

The Need for an Accounting System

Accounting, as an information system is the process of identifying, measuring and communicating the economic information of an organisation to its users who need the information for decision making. It identifies transactions and events of a specific entity. A transaction is an exchange in which each participant receives or sacrifices value (for example purchase of raw material). An event (whether internal or external) is a happening of consequence to an entity (for example use of raw material for production).An entity means an economic unit that performs economic activities.

So we can say that, whenever money is involved, accounting is required to account for it. Accounting is often called the language of business. The basic function of any language is to serve as means of communication. Accounting serves this function.

Establishing an Accounting System

An accounting system is an organised set of manual and computerised accounting methods, procedures and controls established to gather, record, classify, analyse, summarise, interpret and present accurate and timely financial data for management decisions.

There are components of an accounting system but we must first think of the accounting system as a wheel whose hub is the general ledger. Feeding the hub information is the spokes of the wheel. These include:

- Accounts receivable
- Accounts payable
- Order entry
- Inventory control
- Cost accounting
- Payroll
- Fixed assets accounting

These components are ledgers themselves. They are called sub-ledgers. Each one contains the detailed entries of its specific field, such as accounts receivable. The sub-ledgers summarise the entries, then send the summary up to the general ledger. For example, each day the receivables sub-ledger records all credit sales and payments received. The transactions net together then go up to the general ledger to increase or decrease A/R, increase cash and decrease inventory.

We will always check to be sure that the balance of the sub-ledger exactly equals the account balance for that sub-ledger account in the general ledger. If it does not balance then there is a problem.

Think of the general ledger as a sheet of paper on which transactions from all four categories of accounts, assets, liabilities, income and expenses are recorded. Some of them flow up from various sub-ledgers and some are entered directly into the general ledger through a general journal entry. An example of such direct entry would be the payment of a loan. The same concept of a sheet of paper holds for each sub-ledger that feeds the general ledger. A computerised accounting system works the same way, except that the general ledger and sub-ledgers are computer files instead of sheets of paper. Entries are posted to each and summarised. The summary is then sent up to the general ledger for posting.

Many small business owners tend to focus on the more glamorous aspects of their business like sales and marketing and product or service development. As a result, accounting does not get the attention it deserves. In addition to the perception than an accounting system does not necessarily add value, they can also be a little intimidating. However, setting up an accounting system does not have to be complicated and should be considered essential for any small business or self-employed owner.

There are seven steps in setting an accounting system:

Step 1: Pick an Accounting Method

The first decision to be made is which type of accounting method to choose. There are two choices:

- The cash method or cash basis: This means that you count income when you actually receive it (cash, credit card charges or check) and your expenses are counted when you actually pay them. This is the most common method for small businesses, especially those that take immediate payment for a product or service (credit card, cheque, cash).
- The actual method or accrual basis: This means that you count the income when a sale is made (regardless if you actually receive the money for it) and expenses are counted when you actually receive the good service (instead of paying immediately). This method is common for larger businesses or small businesses that utilise "invoicing" and frequently deliver a product or service before being paid for it. The accrual method is generally considered to a more accurate picture of the company's financial situation but it requires the manager of the company to take extra steps to maintain accounts receivable and accounts payable records. The cash method is generally easier to maintain and is the preferred method for small businesses.

Step 2: Decide which bookkeeping system to use

After you have chosen your accounting method, you will want to decide which bookkeeping system will be right for your new venture. There are two choices:

- Single entry bookkeeping: Similar to a check register. Just add the money coming in and subtract the money going out and keep a running balance.
- Double entry bookkeeping: Tracks your income and expenses and your assets and liabilities. Assets and liabilities are captured on the balance sheet.

Step 3: Choose a Method for Recording Transactions

After you have decided on an accounting method, the next step is to decide how you are going to record transactions. You have two choices:

- Manually recording transactions: You handwrite each transaction in a ledger.

- Accounting software: You enter transactions into a software programme which then automates many routine tasks.

By far the most popular method is software. There are dozens of accounting software packages and most of them will help you to maintain your books as well as automate things like payroll and reports.

Step 4: Create Templates

Create your own purchase order and invoice templates. Accounting software users will find templates within the software programme. Spreadsheet users can download a variety of templates from the software manufacturer. Invoices should include the date, business information, customer information, amount due, payment terms or due date and description of the services or goods provided. Begin using the purchases and invoices to record the customer sales.

Step 5: Create a Filing System

- Use file folders and labels to organise financial documents.
- Maintain bank statements, customer invoices, vendor bills, government assessments in separate files.
- Investing in colour coded file folders can greatly facilitate file retrieval.
- File regularly to avoid scrambling at the end of the year.
- Maintain separate folders for outstanding invoices, bills and other documents which require follow up.

Step 6: Open a Business Bank Account

It is very important that a separate bank account must be opened for your small business. Do not pay personal expenses out of this account. If you need money from your business for personal expenses write yourself a cheque and transfer it to your personal bank account.

Step 7: Organise the Accounting Department

Organise your small-business accounting system by function. Often there is just one person to do all the transaction entries. From an internal control standpoint, this is not desirable. Having too few people doing all accounting opens the door for embezzlement. Companies with more people assign functions in such a way that those done by the same person do not pose a control threat.

Having the same person draft the checks and reconcile the checking account is a good example of how to assign accounting duties. We will talk extensively about internal control later. However, for now, small businesses often cannot afford the number of people needed for an adequate separation of duties. The internal control structure that we will install in your new accounting system helps mitigate that risk through mechanics and procedures rather than expensive people.

Monitoring the Accounting System

Once the accounting system has been chosen, the next step is learning and maintaining. Learning the system will obviously depend on what solution you have adopted, but maintaining the system will be accomplished have by primarily two things:

- You have to use the system. Once you have taken the time and energy to set up an accounting system, you have to actually utilise it properly. This means that entering every transaction, cheque, bill, charge or refund.
- Reconcile your bank statement. The best way to maintain your accounting system is by reconciling your bank statement with your accounting system every month. This means that you compare each transaction from your bank account or accounts with your accounting system and make sure that they balance. This process alone will force you to properly account for the company's money.

Taxation Requirements

SARS is obligated by law to determine and collect from each taxpayer only the correct amount of tax that is due to the government. SARS officers are the representatives of the Commissioner and in that capacity must ensure that the tax laws are administered correctly and fairly so that no one is favoured of prejudiced above the rest.

Registration

As soon as you start your business (whether as a sole proprietor, partner or in any other form), you are required to register with your local SARS office in order to obtain an income tax reference number.

Forms of Taxes

The following are the main forms of taxation.

Employee's Tax (PAYE)

Employees' tax is a system in terms of which an employer, as an agent of government, deducts income tax from the earnings of the employees and pays it over to SARS on a monthly basis. Once registered, the employer will receive a monthly return (EMP21) that must be completed and submitted together with the deducted employees' tax within seven days of the month following the month for which the tax was withheld.

Income Tax

A sole proprietor or each partner is subject to income tax on his / her taxable income. Income tax is levied at progressive rates ranging from 18% to 40%. For the 2017 tax year, the maximum marginal rate of 41% applies where the taxable income exceeds R 701,300. Unlike individuals, a company or CC pays income tax at a flat rate of 28% (except in the case of SBS) on its taxable income for the tax year and 10% secondary tax on companies (STC) on the net amount of dividends.

Value Added Tax (VAT)

Value Added Tax (VAT) is an indirect tax based on consumption of goods and services in the economy. Revenue is raised for the government by requiring certain traders or vendors to register and charge VAT on taxable supplies of goods or services.

The most important document in such a system is the tax invoice. Without a proper tax invoice, you cannot deduct input tax on purchases for your enterprise, and if you have clients who are vendors or if you sell goods to foreign tourists, they cannot claim back the VAT that you have charged them, or claim a refund of the VAT when taking the goods out of the country.

The following information must be reflected on a tax invoice for it to be considered valid:

Full Tax invoice (Consideration of R3 000 or more) Section 20(4) of the VAT Act.	**Abridged Tax invoice (Consideration less than R3 000) Section 20(5) of the VAT Act.**
○ The words "**TAX INVOICE**" in a prominent place;	○ The words "**TAX INVOICE**" in a prominent place;
○ Name, address and VAT registration number of the supplier;	○ Name, address and VAT registration number of the supplier;
○ Name, address and VAT registration number of recipient*;	- - -
○ Serial number and date of issue;	○ Serial number and date of issue;
○ Full and proper description of the goods and/or services;	○ A description of the goods and/or services;
○ Quantity or volume of goods or services supplied;	- - -
○ Price & VAT (according to any of the 3 approved methods discussed overleaf).	○ Price & VAT (according to any of the 3 approved methods discussed overleaf).
<u>**Note:**</u> ***Required with effect from 1 March 2005.**	

The following important points should also be noted with regard to tax invoices:

- A vendor is required to issue a tax invoice to the recipient within 21 days of the supply having been made where the consideration for the supply exceeds R 50, whether the recipient has requested this or not.
- If the consideration in money for the supply is R 50 or less, a tax invoice is not required. However, a document such as a till slip or sales docket will still be required to verify the input tax claimed.
- Where the consideration for a taxable supply exceeds R 50 but does not exceed R 3,000 an abridged tax invoice may be issued (see example above).
- A tax invoice must be in South African currency, except for a zero-rated supply (for example goods exported). In such cases, a full tax invoice must be issued, even if the consideration is less than R 3,000.
- A tax invoice is not issued by a debtor (vendor) under an instalment

credit agreement if the goods are repossessed. This will be done by the person exercising their right of repossession (for example the bank or another financier).

- It is a requirement to reflect the VAT registration number of the recipient of the supply on the tax invoice with effect from 1 March 2005 (if that person is a vendor) and the consideration for the supply exceeds R 3,000.
- If a vendor fails to deduct input tax in respect of a particular tax period, it may be deducted in a later tax period, but limited to a period of five years from the date that the supply concerned was made.

practical

Complete the following formative assessment:

F263474.3 – Team Work Sample Presentation

Chapter 8
Analysis of Income and Expenditure Statements

Income and Expenditure Statements

The financial statement can be identified as the success of the small business. Financial statements can be used as a roadmap on your business journey to economic success. Using the numbers as navigation aids can steer you in the right direction and help you avoid costly breakdowns.

Many businesses experts and accountants recommend that you prepare financial statements monthly, or quarterly at a minimum. Some companies prepare them at least once a week, sometimes daily, to stay abreast of results. The more frequently a company prepares their financial statements, the sooner timely decisions can be made.

Types of Financial Statements

Compiled Statement

Compiled statements contain financial data from a company reported in a financial statement format by a certified public accountant and it does not include any analysis of the statement.

Reviewed Statement

Reviewed statements include an analysis of the statement by the certified public accountant in which unusual items or trends in the financial statement are explained.

Audited Statement

Audited statements contain any analysis which includes confirmation with the outside parties, physical inspection and observation, transactions traced to supporting documents. An audited statement offers the highest level of accuracy.

Unaudited Statement

Unaudited statements are financial statements prepared by the company which have not been compiled, reviewed or audited by an outside certified public accountant.

Small business owners must be aware that they may be required to submit financial statements in the following circumstances:

- Virtually all suppliers of capital, such as banks, finance companies, and venture capitalists, require these reports with each loan request, regardless of the previous successful loan history. Banks may need certified public accountants compiled or reviewed statements and in some cases audited statements. They may not accept company or individually prepared financial statements unless they are backed by personal or corporate income. Typically, a condition of granting a loan, a creditor may request periodic financial statements in order to monitor the success of the business and spot any possible repayment problems.

- Information from financial statements is necessary to prepare federal and state income tax returns.
- Statements themselves need to be filed.
- Prospective buyers of a business will ask to inspect financial statements and the financial / operational trends they reveal before they will negotiate a sale price and commit to the purchase.
- In the event that claims for losses are submitted to insurance companies, accounting records (particularly the balance sheet) are necessary to substantiate the original value of fixed assets.
- If business disputes develop, financial statements may be valuable to prove the nature and extent of any loss. Should litigation occur, lack of such statements may hamper preparation of the case.
- Whenever an audit is required, for example by owners or creditors, four statements must be prepared: a balance sheet or statement of financial position, reconcilement of equity or statement of stockholders equity for corporations, income statements or statement of earnings and statements of cash flows.
- A number of countries require corporations to furnish shareholders with annual statements. Certain corporations, whose stock is closely held, that is owned by a small number of shareholders are exempt.

Sources of Income and Expenditure Statements

The income and expenditure sources are as varied as the types of industries and business in operation. People derive their income and spend their money in all possible ways. The ways of income are many and they vary, it is your task to identify these in the financial statements and be able to differentiate between the income and the costs.

An income and expenditure statement is a type of financial document designed to identify all forms of income that is received within a given period, while also documenting all payments or expenditures that were related to that same period.

One of the goals of the income and expenditure statement is to create a tool that is helpful with the task of financial management. To this end, all types of income and expenditures relevant to the period are taken into consideration. This means that both realised and unrealized income that is known at the time is included in the statement detail, along with both paid and unpaid debt obligations. There are a few exceptions that may apply, such as the exclusion of income that is generated by the sale of a capital asset, or the income or sales that are connected with a legacy.

The value of an income and expenditure statement, whether for a recently completed time period or as a projection for an upcoming period, is to have some idea about the financial well-being of the company. This approach makes it possible to analyse basic information that may in turn trigger some changes in the way the company manages debt or how available resources are utilised. Along with companies that function in order to make a profit, other organisations such as clubs, societies, or even hospitals operated by charitable organisations can make use of this particular tool in tracking the relationship between income and the management of debt.

Under the best of circumstances, the income and expenditure statement will indicate that the current level of revenue generation from various sources is sufficient to sustain the operation, given the amount of debt that is currently being managed. By comparing each income and expenditure statement associated with several successive periods, it is possible to identify positive or negative trends that can be evaluated more closely and possibly yield ideas on how to arrange company finances to better advantage. Doing so can increase the chances of strengthening the financial position of the company or at least keeping damage to that stability as low as possible during some sort of broader economic turndown.

Evaluating Income and Expenditure Statements

The concept of "a going concern" is an important accounting concept. Financial statements are usually prepared with the assumption that the enterprise is a going concern, without evidence to the contrary. This assumption implies that the business will continue its operations.

Financial Viability

Financial viability entails that:

- The concern will continue its operations in the foreseeable future.
- The enterprise is sufficiently profitable (or will be in the future) to continue its operations.
- There is inherent worth in continuing operations. This is related to the concept of going profits. It is important to note that sometimes companies do not make a profit every year, especially in the first few years of operations.

A businessperson would examine financial statements for the financial viability and also take a view on inherent worth. A full assessment or analysis of a company does not just look at one year in isolation. Many years of operational results need to be examined for fundamental analysis.

Creating an Income and Expenditure Statement

An income statement, otherwise known as a profit and loss statement, is a summary of a company's profit or loss during any one given period of time, such as a month, three months, or one year. The income statement records all revenues for a business during this given period, as well as the operating expenses for the business.

What is an Income?

Income is defined as money that has been made within the time period of the statement. It is an important accounting concept to correctly account for income within the appropriate time period of the financial statement. This means that you should include your income figure in the month where it belongs even if money has not been received.

What is Expenditure?

Expenditure is defined as the costs that have been incurred within the time period of the statement. As with the concept of income, you should include expenditure in the period in which it was incurred even if no money was paid. This ensures that you have an accurate statement of income and expenditure of real expenditures incurred within the period.

What is a Profit or a Loss?

At the end of the income and expenditure statement, you should subtract expenditure from income remaining with a proportion which enterprises call a profit or loss. If the income items are more than the expenditure items we call that profit but if the expenditures and more than the income then the difference is known as a loss.

practical

This chapter is assessed and integrated with the activities of module 3 and 4 of the Citrus Business Management Programme.

Chapter 9
Analysis of the Balance Sheet

The Balance Sheet

The balance sheet is a financial statement which reflects the financial position of a business at a specific date. This date is usually the first and / or last day of the financial year.

The financial status of the business is determined by three aspects namely assets, liabilities and net worth (ownership interest or own capital). The balance sheet is the systematic presentation of these three aspects as at a specific date, with each item identified in terms of and linked to a money value. It is, therefore, the presentation of historical information which reflects the cumulative effect of finalised transactions, without indicating how the current financial position was reached.

The assets recorded on the balance sheet represent all the possessions of the business, namely land, buildings, machinery and equipment, stocks and cash. The asset side of the balance sheet is always based on the inventory. An inventory is collected during a "stock-taking" exercise.

The liabilities recorded on the balance sheet represent the difference between the assets and liabilities recorded on the balance sheet. These include all the debts and liabilities of the business as at the date of the balance sheet.

The net worth of the business as at the date of the balance sheet is the difference between the assets and liabilities recorded on the balance sheet. The net worth is also called ownership interest or own capital and is, therefore, the amount the entrepreneur would retain after having sold all his assets and paid all his debts. If the net worth is negative, the entrepreneur is insolvent or bankrupt.

The net worth is entered on the liability side of the balance sheet and represents the amount which the business owes the owner. The asset side of the balance sheet indicates all the assets of the business as at the date of the balance sheet, while the liability side indicates how these assets have been financed. The following basic accounting formula can be deduced from the above:

Assets = Liabilities + Net Worth

As the word "balance sheet" implies, the two sides of the comparison should always be equal. A transaction which therefore influences one side of the comparison must cause an identical change on the other side.

The ratio between the various types of assets and liabilities is important when the financial position of a business is investigated. For this reason, assets and liabilities with similar features are grouped together and recorded on the balance sheet in a systematic manner.

The following table is an example of a balance sheet for a citrus farm in KwaMhlanga. A balance sheet is a simple indication of the assets and liabilities of a business. It does not show the profitability of a business. It measures the financial position or wealth of an enterprise.

KwaMhlanga Citrus Farm		
Balance sheet as at 30 March 2017		
Assets		R
Cash in bank		**5 000**
Land and buildings		**500 000**
Tools		**10 000**
Inventories		**12 000**
Implements		**300 000**
		R 827 000
Equity and liabilities		
Equity		
Capital		**714 000**
Liabilities		
Loan	**100 000**	
Payables	**6 000**	
Bank overdraft	**7 000**	**113 000**
		R827 000

Long-term and Short-term Liabilities

There are two sides to a balance sheet, one side shows the assets and the other side shows the liabilities. On the liability side, all the debts and obligations owed by the business to outside creditors, vendors, or banks that are payable within a period of one year, including the owner's equity are shown.

Just like assets, liabilities can be classified into three categories, namely current liabilities, medium-term liabilities and long-term liabilities. The order in which liabilities are recorded on the balance sheet is once again based on the duration of the repayment period.

- Current liabilities (or short-term liabilities) are debt commitments payable within twelve months and include items such a bank overdraft, unpaid cheques, overdue debts, co-operative accounts, commercial creditors and provision made for instalments on medium and long-term loans.
    - Accounts payable: This is comprised of all short-term obligations owed by your business to creditors, suppliers, and other vendors. Accounts payable can include supplies and materials acquired on credit.
    - Notes payable: This represents money owed on a short-term collection cycle of one year or less. It may include bank notes, mortgage obligations, or vehicle payments.
    - Accrued payroll and withholding: This includes any earned wages or withholdings that are owed to or for employees but have not yet been paid.

- Total current liabilities: This is the sum total of all current liabilities owed to creditors that must be paid within a one-year time frame.

❖ Medium-term liabilities are debt commitments which have to be paid within one to ten years and include instalment sale credit, leasing and medium-term loans (private or at the Land Bank).

❖ Long-term liabilities represent all debt commitments which have to be discharged over a period of ten years or longer. Mortgage bonds and other long-term loans are examples of long-term liabilities.

Total Liabilities comprises all debts and monies that are owed to outside creditors, vendors, or banks and the remaining monies that are owed to shareholders, including retained earnings reinvested in the business (defined below as owner's equity).

Assets and Liabilities

Assets are classified according to their liquidity or their ability to be converted into cash. Accordingly, there are three categories of assets, namely current assets, medium-term assets and fixed assets.

❖ Current assets (also known as short-term or working capital) are the most liquid assets and consist of items such as cash on hand, cash in the bank, stocks, debtors, finished and unfinished products, short-term investments and prepaid accounts. These assets can easily be converted to cash in a twelve-month cycle without disrupting the business.

  - Cash: This is the most liquid of all assets (short-term assets). This can be available in the form of checking accounts.
  - Debtors or accounts receivables: This is the money outstanding to the business or that is owed by customers, suppliers, and other vendors who have done purchases from the business.

❖ Medium-term assets (also called movable assets) are used in the production process to produce items which can be sold over a period but are usually consumed over the medium term (normally two to ten years). Movable assets include items such as vehicles, machinery, implements, tools, equipment, orchards, breeding-stock, plantations and medium-term investments. Most of these assets are subject to depreciation.

❖ Fixed assets are also used in the production process, but have a longer serviceable life (usually more than ten years). Fixed improvements and land are examples of fixed assets.

❖ Total assets is the figure that shows the total Rand value of both the short-term and long-term assets of a business.

Owner's Equity

Sometimes this is referred to as stockholders' equity. Owner's equity is made up of the initial investment in the business as well as any retained earnings that are reinvested in the business.

Equity and / or Financial Net Worth

A balance sheet is drawn up at a specific date and can be completed for any specific calendar day. It is, however, important that it should correlate with the period for which the entrepreneur summarises his income and expenditure (income statements), in order to make a meaningful and informative financial analysis of the business possible. An accounting period or financial year should, therefore, be chosen and all financial statements should be based on this period. The balance sheet should be completed at the end of this period, whether it be a calendar year, tax year or production year. Thus the closing balance sheet for one period serves as the opening balance sheet for the following period.

It should be stressed that the valuation and recording of assets on the balance sheet are based on the inventory. The relevant items are carried over from the inventory to the balance sheet. The balance sheet reflects the financial position of the business as at a specific date (in this case the beginning and / or end of the production year) and presents a static image of the business.

Balance sheets can be structured in various ways. Below is an example of a traditional balance sheet required for the meaningful analysis and interpretation of the financial results of the business (Figure 1), while an example of a modern balance sheet is given in Figure 2. The traditional balance sheet is recommended because it is more detailed.

In the balance sheet in Figure 2 headings are included to facilitate completion. Although the given headings are normally sufficient, more unusual assets and liabilities may exist. Additional space has therefore been provided in each category to accommodate such items. The reason for the double columns with spaces for dates at the top is that the balance sheet should be used to indicate opening and closing values for the financial or accounting period. This will enable the manager to establish immediately how the financial status of the business has changed in a given period.

LIABILITIES	**DD/MM/YYYY**	**DD/MM/YYYY**	**ASSETS**	**DD/MM/YYYY**	**DD/MM/YYYY**
CURRENT LIABILITIES			**CURRENT ASSETS**		
Bank(s)			Cash on hand / in bank		
Co-operative(s)			Debtors		
Creditors			Prepaid expenses		
Income tax			Life assurance		
Bills payable			Negotiable securities		
Current portion of term commitments:			Stock:		
Term loans			• Crops and crop products		
instalment sale payments			• Livestock products		

LIABILITIES	**DD/MM/YYYY**	**DD/MM/YYYY**	**ASSETS**	**DD/MM/YYYY**	**DD/MM/YYYY**
Lease payments			• Production inputs		
Bond repayments			• Marketable livestock		
Agricultural Credit Board			Other		
Long-term loans					
Other loans					
Other					
TOTAL CURRENT LIABILITIES (A)			**TOTAL CURRENT ASSETS (D)**		
MEDIUM TERM LIABILITIES			**MEDIUM TERM ASSETS**		
Term loans			Breeding stock		
Instalment sale credit			Vehicles, Machinery and equipment		
leases			Other		
TOTAL MEDIUM TERM LIABILITIES (B)			**TOTAL MEDIUM TERM ASSETS (E)**		
LONG TERM LIABILITIES			**FIXED ASSETS**		
Bonds			Fixed improvements		
Agricultural Credit Board			Land		
Long-term loans			Other		
TOTAL LONG-TERM LIABILITIES (C)			**TOTAL FIXED ASSETS (F)**		
TOTAL LIABILITIES (A + B + C) = (J)			**TOTAL ASSETS (D + E + F) = (G)**		
NET WORTH (G-J) = (K)	(a)	(b)			
TOTAL (C + J)			**VALUE OF RENTED LAND (H)**		
GROWTH IN NET WORTH (K(b) - K(a))			**TOTAL CAPITAL EMPLOYED (G + H)**		

Two aspects of the balance sheet warrant further explanation:

The value of rented items is not an asset and should therefore not be included in the balance sheet. For practical purposes, the value of leased items is included under medium-term assets. Rented land and buildings are, however, not included in the balance sheet, but for the sake of completeness and for comparative and analytical purposes they are indicated as a type of annexure under the total assets of the business. The sum total of the total assets of the business and the value of rented land represents the total capital employed in the business.

Long and medium-term loans are repaid in periodic instalments. If such an instalment is payable within the following twelve months, it represents a short-term liability. The total instalment is brought into account under short-term liabilities. Instalments usually consist of two components, namely an interest component and a capital component. Although the total instalment is included as a short-term liability, the existing long or medium-term loan is decreased by the capital component of the payment only.

Figure 2: Example of a modern balance sheet

Balance Sheet as at 30 July 2017	
Current assets	XXX (A)
Minus: current liabilities	XX (B)
Net current assets (liabilities) (A – B)	X (C)
Plus: Investments	X (D)
Plus: Medium-term assets	X (E)
Plus: Fixed Assets	X (F)
Net total assets (C + D + E + F)	XXX (G)
Financed through:	
Medium-term liabilities	X (H)
Long-term liabilities	X (I)
Net worth (G – H – I)	XX (J)
Net total assets (G – K)	XXX (K)

Drawing up a Balance Sheet

The process of preparing a balance sheet depends on the ability to classify trial balance items into assets, liabilities and capital.

Prepare the trading, profit and loss account and balance sheet using the following information.

KK Investments - Trial Balance as at 31 December 2017		
-	Dr (R)	Cr (R)
Sales	-	6000
Purchases	4000	-
Insurance	650	-
Lighting & heating	450	-
General expenses	120	-
Machinery	2100	-
Debtors	890	-
Creditors	-	980
Bank	1970	-
Discounts allowed	130	-
Discounts received	-	110
Cash in hand	80	-
Drawings	700	-
Capital	-	3000
Loan	-	1000
-	11090	11090

Stock in trade as at 31 December 2017 was valued at R300

Trading Account:

KK Investments – Trading Account for year ended 31 December 2017		
-	R	R
Sales	-	6000
Less Cost of goods sold:	-	-
Purchases	4000	-
Less Closing stock	300	3700
Gross Profit	-	2300
Add Discount received	-	110
Less Expenses:	-	2410
Insurance	650	-
Lighting & heating	450	-
General expenses	120	-
Discounts allowed	130	1350
Net profit	-	1060

Balance sheet:

KK Investments Balance Sheet as at 31 December 2017			
	ASSETS		
Fixed Assets			
Machinery		**2100**	
Investments		**-**	
Total fixed assets			**2100**

KK Investments Balance Sheet as at 31 December 2017			
Current Assets:			
Cash & Cash Equivalents		**80**	
bank		**1970**	
Accounts Receivable		**890**	
Inventories		**300**	
Prepaid Expenses		**-**	
Total Current Assets		**3240**	
Less: Current Liabilities			
Current Liabilities:			
Accounts Payable	**980**		
Accrued Expenses	**-**		
Short-term Loans	**-**		
Current Portion of LT Debt	**-**		
Income Taxes Payable	**-**		
Total Current Liabilities		**(980)**	
Working Capital			**2260**
			4360
FINANCE BY:			
Capital			**3000**

KK Investments Balance Sheet as at 31 December 2017			
Current Year Earnings			**1060**
Retained Earnings			**-**
Total Capital			**4060**
Less Drawings			**700**
			3360
LONG-TERM LIABILITIES			
Loan			**1000**

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This chapter is assessed and integrated with the activities of module 3 and 4 of the Citrus Business Management Programme.

Chapter 10
Financial Decisions

Using Financial Ratios as a Guideline

A financial ratio is a relationship that indicates something about a company's activities, such as the ratio between the company's current assets and its current liabilities or between its debtors and its turnover.

The basic source of these ratios is the company's profit and loss account and balance sheet that contain all kinds of important information about that company. The ratios really help to bring those details to light and identify the financial strengths and weaknesses of the company.

When assessing ratios, it is important that the results are compared with other companies in the same industry and not to be taken in isolation. What may seem like a poor ratio at first glance may well be normal for that industry and, of course, the reverse applies, in that what may seem a good ratio on its own, could be below average for that industry.

Profitability Ratios

These ratios tell us whether a business is making profits - and if so whether at an acceptable rate. The key ratios are:

Ratio	**Calculation**	**Comments**
Gross Profit Margin	[Gross Profit / Revenue] x 100 (expressed as a percentage	This ratio tells us something about the business's ability to consistently control its production costs or to manage the margins its makes on products its buys and sells. Whilst sales value and volumes may move up and down significantly, the gross profit margin is usually quite stable (in percentage terms). However, a small increase (or decrease) in profit margin can produce a substantial change in overall profits.
Operating Profit Margin	[Operating Profit / Revenue] x 100 (expressed as a percentage)	Assuming a constant gross profit margin, the operating profit margin tells us something about a company's ability to control its other operating costs or overheads.

Liquidity Ratios

Liquidity ratios indicate how capable a business is of meeting its short-term obligations as they fall due:

Ratio	**Calculation**	**Comments**
Current Ratio	Current Assets / Current Liabilities	A simple measure that estimates whether the business can pay debts due within one year from assets that it expects to turn into cash within that year. A ratio of less than one is often a cause for concern, particularly if it persists for any length of time.
Quick Ratio (or "Acid Test"	Cash and near cash (short-term investments + trade debtors)	Not all assets can be turned into cash quickly or easily. Some - notably raw materials and other stocks - must first be turned into a final product, then sold and the cash collected from debtors. The Quick Ratio, therefore, adjusts the Current Ratio to eliminate all assets that are not already in cash (or near-cash) form. Once again, a ratio of less than one would start to send out danger signals.

Stability Ratios

These ratios concentrate on the long-term health of a business, particularly the effect of the capital / finance structure on the business:

Ratio	**Calculation**	**Comments**
Gearing	Borrowing (all long-term debts + normal overdraft) / Net Assets (or Shareholders' Funds)	Gearing (otherwise known as leverage) measures the proportion of assets invested in a business that is financed by borrowing. In theory, the higher the level of borrowing (gearing) the higher are the risks to a business, since the payment of interest and repayment of debts are not optional in the same way as dividends. However, gearing can be a financially sound part of a business's capital structure particularly if the business has strong, predictable cash flows.
Interest cover	Operating profit before interest / Interest	This measures the ability of the business to service its debt. Are profits sufficient to be able to pay interest and other finance costs?

Cost Income Ratio

The cost-to-income ratio is an important indicator of the value of the company. It is used a lot in investment analysis to ascertain how easily the company can increase profits. The cost-to-income ratio shows the efficiency of a firm in minimising costs while increasing profits. The lower the cost-to-income ratio, the more efficient the firm is running. The higher the ratio, the less efficient management is at reducing costs. Cost-to-income ratio equals a company's operating costs divided by its operating income.

Financial Strengths and Weaknesses

Financial statement analysis is defined as the process of identifying financial strengths and weaknesses of the firm by properly establishing the relationship between the items of the balance sheet and the profit and loss account.

There are various methods or techniques that are used in analysing financial statements, such as comparative statements, schedule of changes in working capital, common size percentages, funds analysis, trend analysis, and ratios analysis.

Financial statements are prepared to meet external reporting obligations and also for decision-making purposes. They play a dominant role in setting the framework of managerial.

The financial strengths and weaknesses of a business may include:

- Debt reduction planning (what should / can we do with our debt?)
- Mortgage analysis (do you have the most appropriate mortgage for your situation?)
- Savings analysis (are you saving enough? Are you saving too much?)

Quantitative evaluations of business processes and financial results are a standard way of evaluating the health and competitive position of a company. Financial ratios are often derived from the published balance sheet, income statement and cash flow statement of a public company. Financial ratios can be used within a business to track and monitor financial progress or externally by analysts, investors and customers. Common ratios include the current ratio that evaluates assets and liabilities, working capital ratio, return on assets, return on equity, profit margin, asset turnover, price-to-earnings ratio and return on assets.

Another thing that can best describe the weaknesses and the strengths of the business venture is a SWOT analysis as it provides decision-makers with a concise evaluation of a company's ability to compete and illustrates to investors management's knowledge and strategic planning contingencies. The analysis evaluates not only threats from competitors but threats such as tax policy, government regulation, new technologies and laws that can adversely impact the company's business model.

practical

Complete the following formative assessment:

F263474.4 – Team Brainstorming Session, Research and Conclusion