Module 1

LEARNER GUIDE

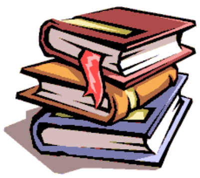
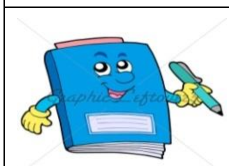
MANAGE WORKING CAPITAL

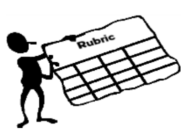
Learner Information:

Details	Please Complete this Section
Name & Surname:	
Organisation:	
Unit/Dept:	
Facilitator Name:	
Date Started:	
Date of Completion:	

Key to Icons

The following icons may be used in this Learner Guide to indicate specific functions:

 Books	This icon means that other books are available for further information on a particular topic/subject.
 References	This icon refers to any examples, handouts, checklists, etc…
 Important	This icon represents important information related to a specific topic or section of the guide.
 Activities	This icon helps you to be prepared for the learning to follow or assist you to demonstrate understanding of module content. Shows transference of knowledge and skill.
 Exercises	This icon represents any exercise to be completed on a specific topic at home by you or in a group.

 **Tasks/Projects**	**An important aspect of the assessment process is proof of competence. This can be achieved by observation or a portfolio of evidence should be submitted in this regard.**
 **Workplace Activities**	**An important aspect of learning is through workplace experience. Activities with this icon can only be completed once a learner is in the workplace**
 **Tips**	**This icon indicates practical tips you can adopt in the future.**
 **Notes**	**This icon represents important notes you must remember as part of the learning process.**

Learner Guide Introduction

About the Learner Guide…	This Learner Guide provides a comprehensive overview of the Perform Financial Planning and Control Functions for a Small Business, and forms part of a series of Learner Guides that have been developed for **National Certificate: Small Business Financial Management at NQF Level 4, worth 120 credits.** The series of Learner Guides are conceptualized in modular's format and developed **National Certificate: Small Business Financial Management Learning Programme.** They are designed to improve the skills and knowledge of learners, and thus enabling them to effectively and efficiently complete specific tasks. Learners are required to attend training workshops as a group or as specified by their organization. These workshops are presented in modules, and conducted by a qualified facilitator.
Purpose	The purpose of this Learner Guide is to provide learners with the necessary knowledge related to **Manage working capital**
Assessment Criteria	The only way to establish whether a learner is competent and has accomplished the specific outcomes is through an assessment process. Assessment involves collecting and interpreting evidence about the learner's ability to perform a task.

	This guide may include assessments in the form of activities, assignments, tasks or projects, as well as workplace practical tasks. Learners are required to perform tasks on the job to collect enough and appropriate evidence for their portfolio of evidence, proof signed by their supervisor that the tasks were performed successfully.
To qualify	To qualify and receive credits towards the learning program, a registered assessor will conduct an evaluation and assessment of the learner's portfolio of evidence and competency
Range of Learning	This describes the situation and circumstance in which competence must be demonstrated and the parameters in which learners operate
Responsibility	The responsibility of learning rest with the learner, so: • Be proactive and ask questions, • Seek assistance and help from your facilitators, if required.

Learning Unit 1 MANAGE WORKING CAPITAL

UNIT STANDARD NUMBER	**:**	114740
LEVEL ON THE NQF	**:**	4
CREDITS	**:**	5
FIELD	**:**	Business, Commerce and Management Studies
SUB FIELD	**:**	Finance, Economics and Accounting

<table>
<tr><td>PURPOSE:</td><td>This Unit Standard is for people who are responsible for controlling the finances of a small business or who are responsible for the bookkeeping aspect of financial management in larger organisations.

The qualifying learner will be able to:
• Calculate working capital in a business.
• Identify and explain the dangers of over trading.
• Demonstrate the effects that external and internal events and actions have on cash flow.
• Calculate an approximate APR for an organisation.</td></tr>
<tr><td colspan="2">LEARNING ASSUMED TO BE IN PLACE:</td></tr>
<tr><td colspan="2">It is assumed that learners are competent in Communication, Mathematical Literacy and Accounting at NQF Level 3.</td></tr>
</table>

SESSION 1. Calculate the level of working capital in a business
Learning Outcomes
• The current assets and liabilities of an organisation are calculated correctly. • The working capital of the organisation is calculated using all available information.

Current assets and liabilities of an organization

Accounting is fundamentally about Assets, Liabilities and Equity. Once you understand what these are, you will be well on your way to understanding Accounting.

Beginners will be happy to know that the general day to day meaning of the word 'asset' relates perfectly to the accounting meaning. So when you listen to phrases such as "Mr. X or Miss Y is an asset to the organization" you know that the speaker is implying that these individuals are of value to the company.

In the accounting sense, **an asset** is an item of value owned by a company. Assets may be tangible physical items or intangible items with no physical form. Assets add value to a company, and are important to a company's continued success.

As with assets, you may look at the wider world to gain an understanding of what's a liability. No one is particularly pleased when he or she is described as a "liability". This is so because the liability description is a negative one.

In accounting, **liabilities** are obligations of the company to transfer something of value (an asset - see above) to another party. On a company's balance sheet, a liability may be a legal debt or an accrual, which is an estimate of an obligation.

You're now two thirds of the way to understanding the basics of accounting, and what you'll see on the typical balance sheet. The final third is equity. In day-to-day parlance, you may be familiar with the word "equity" if you're a homeowner. Homeowners who make regular mortgage payments will accumulate equity value in their property, and will be able to borrow against that equity.

Equity is the owner's value in an asset or group of assets.

In accounting, equity is usually defined as the value of the assets contributed by the owners. This is added to the total income earned and retained by the company to give the company's total equity value. This description of equity is correct but very simplistic. A more profound description is really that used by the homeowner, that is, equity is the owner's value in an asset or group of assets.

As an example, a company with total assets valued at R1,000, may have debt (liabilities) valued at R900, in which case the owner's value in the assets is R100, representing the company's equity.

The following is the **Equity equation:**

Total Assets **minus** Total Liabilities (T - A = E). T - A (or Equity) is also referred to as Net Worth, Capital & Shareholders Equity.

GROUPING ASSETS

Assets are grouped in order of liquidity, not only because it makes sense but also because liquidity is the lifeblood of a company. Liquidity refers to the ease in which an asset can be converted to cash. Cash is therefore the most liquid of all assets.

Assets that are very liquid are shown on the balance sheet as current assets. Current assets are assets that are expected to be converted to cash in 12 months or less. Those assets with convertibility exceeding twelve months are considered to be illiquid and are categorized as fixed or long-term assets.

CURRENT ASSETS

1. Cash
2. Short-term investments
3. Accounts Receivable

4. Inventory

5. Prepayments (Prepaid expenses)

The assets above represent the current assets that are usually found on the typical balance sheet. As shown, the assets are arranged in descending order in order of liquidity, from cash, which is the most liquid asset, to prepayment, which is the least liquid of the five items above.

The management of current assets is fundamental to the operating success of a business. This is where the vital operating assets are found, driving the day-to-day activity of the company. Companies are forced to spend significant sum of money to ensure proper management of current assets

Current Assets and Current Liabilities Examples
While analyzing a balance sheet of a company it is of paramount importance that you have an idea about current assets and current liabilities. Current assets are those assets which can be easily converted into cash within 12 months, given below are some of the examples of current assets - 1. Cash balance available with company 2. Inventories which includes raw materials, work in progress and finished goods. 3. Bank balance of the company 4. Sundry Debtors of the company (in the balance sheet sundry debtors are shown after deducting provision for bad debts). 5. Bills receivables or accounts receivables 6. Prepaid expenses 7. Short term investments like bonds, money market bills, mutual funds and stocks which are expected to be sold in less than a year. Current liabilities are those liabilities which are due for the payment within a short period of time usually 12 months, given below are some of the examples of current liabilities – 1. Sundry Creditors 2. Bills Payable or Account Payable 3. Outstanding or Accrued Expenses like salary outstanding, rent outstanding etc… 4. Unearned Income

5. Short Term Loans
6. Bank loan, which is due within a year
7. Interest, tax and Dividend Payment

Working Capital

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.

A measure of both a company's efficiency and its short-term financial health. The working capital ratio is calculated as:

Working Capital = Current Assets - Current Liabilities

Positive working capital means that the company is able to pay off its short-term liabilities. Negative working capital means that a company currently is unable to meet its short-term liabilities with its current assets (cash, accounts receivable and inventory). Also known as "net working capital", or the "working capital ratio".

If a company's current assets do not exceed its current liabilities, then it may run into trouble paying back creditors in the short term. If current assets are less than current liabilities, an entity has a working capital deficiency, also called a working capital deficit. The worst-case scenario is bankruptcy. A declining working capital ratio over a longer time period could also be a red flag that warrants further analysis. For example, it could be that the company's sales volumes are decreasing and, as a result, its accounts receivables number continues to get smaller and smaller.

Working capital also gives investors an idea of the company's underlying operational efficiency. Money that is tied up in inventory or money that customers still owe to the company cannot be used to pay off any of the company's obligations. So, if a company is not operating in the most efficient manner (slow collection), it will show up as an increase in the working capital. This can be seen by comparing the working capital from one period to another; slow collection may signal an underlying problem in the company's operations.

Calculation

Current assets and current liabilities include *three accounts* which are of special importance. These accounts represent the areas of the business where managers have the most direct impact:

- accounts receivable (current asset)
- inventory (current assets), and
- accounts payable (current liability)

The current portion of debt (payable within 12 months) is critical, because it represents a short-term claim to current assets and is often secured by long term assets. Common types of short-term debt are bank loans and lines of credit.

An increase in working capital indicates that the business has either increased current assets (that it has increased its receivables, or other current assets) or has decreased current liabilities—for example has paid off some short-term creditors.

Implications on M&A: The common commercial definition of working capital for the purpose of a working capital adjustment in an M&A transaction (i.e. for a working capital adjustment mechanism in a sale and purchase agreement) is equal to:

Current Assets – Current Liabilities excluding deferred tax assets/liabilities, excess cash, surplus assets and/or deposit balances.

Cash balance items often attract a one-for-one, purchase-price adjustment.

Management of working capital

Guided by the above criteria, management will use a combination of policies and techniques for the management of working capital. The policies aim at managing the *current assets* (generally cash and cash equivalents, inventories and debtors) and the short term financing, such that cash flows and returns are acceptable.

- **Cash management**. Identify the cash balance which allows for the business to meet day to day expenses, but reduces cash holding costs.
- **Inventory management**. Identify the level of inventory which allows for uninterrupted production but reduces the investment in raw materials - and minimizes reordering costs - and hence increases cash flow. Besides this, the lead times in production should be lowered to reduce Work in Process (WIP) and similarly, the Finished Goods should be kept on as low level as possible to avoid over production.
- **Debtors management**. Identify the appropriate credit policy, i.e. credit terms which will attract customers, such that any impact on cash flows and the cash conversion cycle will be offset by increased revenue and hence Return on Capital (or *vice versa*).
- **Short term financing**. Identify the appropriate source of financing, given the cash conversion cycle: the inventory is ideally financed by credit granted by the supplier; however, it may be necessary to utilize a bank loan (or overdraft), or to "convert debtors to cash" through "factoring"

SESSION 2.

Identify and explain the dangers of overtrading

Learning Outcomes

- The concept of overtrading is explained with examples.
- Low or negative levels of working capital are identified for an organization and an explanation given with regard to the potential risks.

Overtrading means s situation of operating a business entity with insufficient long term capital to support the current volume of business. Overtrading can arise even if the organization is trading profitably. Over-expansion of business is one of the main reasons for overtrading and therefore overtrading is also called under-capitalization.

A swiftly growing business requires additional levels of inventory and receivables to support the growth. This means the working capital requirement increases. When this increase becomes permanent, it should be financed with additional long term capital. When it is financed from a bank overdraft and a shorter operating cycle, the business entity could easily run into severe liquidity problems.

Overtrading Indications & Remedies

In contrast with over-capitalization, overtrading occurs when a firm tries to do too much too quickly with too little long term capital, so that it is trying to support too large trade volume with limited capital resources.

Even a firm operating in profit may find itself in serious conditions because it is in short of money situation.

Such liquidity troubles emerge from the fact that it does not have enough cash to pay off debt as it falls due.

The major signs leading to overtrading are as follows:

- There is significant increase in turnover.

- Increase in current assets is rapid.

- Stock turnover the debtors turnover might slow down, in which case the rate of increase in stocks and debtors would be even greater than the increase in sales.

- Payment to creditors is pushed to increase length.

- Short term loans are exceeding the limits and firm tries to negotiate increased limits.

- The current and quick ratio falls

- The firm leads to liquid deficit situation where current liabilities are greater than current assets. Overtrading takes place when a business accepts work and tries to fulfill it, but fulfillment requires greater resources of people, working capital or net assets than the business has available to it. It is often caused by unforeseen events such as manufacture or delivery taking longer than anticipated, resulting in cash flow being impaired.

The commonly seen symptoms of overtrading
• Rapid increase in revenue • Decrease in liquidity ratios • Piercing increase in sales to non-current assets ratio • Rise in inventory in relation to revenue • Increase in receivables • Rise in the accounts payable period • Increase in short term borrowing • Decline in cash balance • Increase in gearing level • Decrease in profit margin

Overtrading is a common problem, and it often happens to recently started businesses and to rapidly expanding businesses. Cash often has to leave the business before more cash comes into it. For example, wages and salaries are usually payable weekly or monthly and there may also be other expenses that need to be met promptly, such as telephone bills and rent.

Although you may pay suppliers on credit, your customers may also pay you on credit. It doesn't take much to upset the balance.

Remedies

Effective debt management and credit control can help you avoid overtrading, by ensuring that you get paid more efficiently and have the cash to pay suppliers and staff. In addition to managing debt more effectively and improving credit control, you should also think about changing some or all of your business practices.

Set New Payment Terms

You could renegotiate payment terms, or tell customers that new terms will apply for future orders, but you should be aware that customers may object. Much will depend on the strength or weakness of your competitive position. You may lose business if your new terms are unattractive to your customers, or if you are aggressive in imposing them.

Offer Discounts for Prompt Payment

This can be effective in accelerating payment, boosting cash flow and reducing bad debts. However, there are disadvantages - it can be expensive and must be policed to ensure that customers only take discounts when they pay promptly.

Use factoring or invoice discounting

Factoring involves selling your invoices to a specialist finance company which takes on the administration and cost of recovering the invoice payments. With invoice discounting, you raise a loan from a finance company against the value of your invoices, but you keep the responsibility and cost of recovering invoice payments.

How to improve cash flow:

Cash flow problems can be handled in the following ways:

· decreasing the receipt float

· deferring capital expenditure (capex) and developmental work

· accelerating cash inflows which were set for recovery at a later period.

· liquidating investments

· deferring payments to creditors

· rescheduling loan payments

· planning is of immense importance especially rolling cash budgets.

Motives for Cash holding

Transactions Motive ensures that the firm has enough funds to transact its routine, day-to-day business affairs. Safety Motive protects the firm against being unable to meet unexpected demands for cash. Speculative Motive allows the firm to take advantage of unexpected opportunities that may arise.

Possible approaches to effective debt management are given below.

- **Setting new payment terms**

Re-negotiate payment terms or introduce new terms for future orders. Here success will depend on the strength or weakness of the company in the industry or its competitive position in the market. If the new terms are not attractive to customers the company may lose business.

- **Offering discounts for prompt payments**

This will accelerate payments, boost cash flow and reduce bad debts. It can be expensive to the company and customers may not take the offer if not attractive.

- **Automated payments**

This will prevent the risk of bounced or lost cheques.

- **Invoice discounting or factoring**

Factoring means selling invoices to a expert finance company who take over the administration and the cost of recovering the payments.

- **Negotiating terms with suppliers**

Suppliers can be asked to grant longer payment terms but here some suppliers may refuse to continue to trade with the company on credit terms.

- **Improve inventory control**

Quicker inventory turnover will cut the time between paying some suppliers for goods and customers payments

- **Lease/Hire purchase assets**

This will help smooth cash flows to acquire non current assets.

- **Introduction of new capital**

The company can issue new share capital or obtain long term loans.

- **Reduce distribution of profit**

Avoiding payment of dividends will improve cash flow but this may not be a welcome suggestion.

- **Cost cutting**

Cost reduction improving efficiency should increase cash flow and reduce risk of over trading.

SESSION 3. Understand the effects on cash flow of external and internal events and actions
Learning Outcomes
• The external events that can affect the cash flow of an organisation are identified and an explanation given of how each can affect the organisation. • The internal events and actions that can affect the cash flow of an organisation are identified and an explanation given of how each can affect the organisation.

What factors affect your cash flow?

Cash flow is the measure of cash inflow and outflow from your business. Positive cash flow means that you have more money coming into the business and negative cash flow means you have more money leaving. There are several things that can affect cash flow in the business world.

Cash flow can be classified into three different categories:

1. **Operational cash flows**- cash received or expended as a result of core business activities.
2. **Investment cash flows**- cash received or expended through capital expenditure, investments, or acquisitions.
3. **Financing cash flows**- cash received or expended as a result of financial activities like interest and dividends.

Cash flow can be used to determine and measure different things in a company. It can be used to evaluate a performance, determine problems with liquidity, generate project rate of returns, or examine income growth of a business over time.

What factors can affect cash flow?

There are many different factors that can affect cash flow. Here are some factors that might affect the cash flow in your business:

- Overhead expenses and indirect costs. If the price you are paying for your overhead exceeds the money you are bring in then this can become quite a problem as it will definitely limit your cash flow.
- A decrease in prices and payment performances of customers. When there is a decrease in prices it will obviously affect how much money you have coming into the business, as will customer performances. Although a decrease in prices will likely bring in more customers, customer performance can also affect a company's cash flow; especially poor performance.
- Poor credit ratings with customers. Why would this affect you? Well, if they're paying with poor credit it's likely that they won't be able to pay the money back which can set you back quite a bit, especially if you have numerous customers buying on credit.
- The economy. If the economy happens to go into a recession then businesses everywhere are going to suffer and cash flow will suffer greatly as well. The economy plays a large role in the amount of cash flow a company brings in.

Obviously these are only a few of the factors that can affect cash flow in a business. When you are in the business world it's important to consider all factors (if possible) that could possible affect your cash flow and plan accordingly so that you're not caught off guard.

How to improve your cash flow

Believe it or not, if you're not that great with handling cash flow there are things you can do to improve it.

- If you have a lot of customers that are slow payers then try increasing your prices. That might make up for the time it takes for them to pay for your product.

- Don't give every Tom, Dick, or Jane availability to using credit. If you know that their credit is poor then you might want to think twice about letting them use it. And if you have customers using credit make sure you instill late payment charges and fees.
- Check to see how much excess inventory you have in the back. You might be surprised at how much you just have sitting around on the shelves. Sell it to someone or another company that might actually be able to use it.
- Convert your debt into equity.

There are many factors that affect your cash flow. You have to be sure that you consider them all if you're part of the business world. Factors that affect cash flow can keep you in business or put you out of it.

Cash flow - treat the cause not the symptom

The Smith's shop had been profitable from the day they bought it. The shop had run smoothly and there was always money in the bank. Business had progressed so well they decided to move into a larger shop not far away in the same suburb. After the move revenue dropped and cash flow slowed. The business never returned to the same level of success. For the first time in five years they used a bank overdraft and sought a loan from the bank. The business was still making a profit but was struggling with no cash. What went wrong?

The major reason for small business failure is the lack of cash. The lack of cash is a symptom that results from underlying causes. For a business to be successful we need to discover and address the underlying causes for the poor cash flow. Trying to fix poor cash flow without diagnosing the cause is the same as the doctor trying to treat a skin rash without knowing the cause of the skin rash. The treatment will not be very effective if it doesn't address the real reason for the skin rash. Similarly, there are many possible reasons for poor cash flow and usually there is more than one reason that is affecting our business.

Before treating poor cash flow problems in our business we need to diagnose the causes so we can use our resources wisely and effectively.

The causes of poor cash flow can be either external or internal factors. The external factors are those that occur outside of the business and its control. While we may not be able to control external factors we can prepare and reduce the risk and impact of them on our business. Internal factors are those that are within the control of our business. I have outlined below both possible external and internal factors that can affect cash flow.

External Factors

1. **Political** - The influence on business by government. For example, the government increased the taxes on certain products overnight without warning causing a fall in sales not only of those products but also of other products in the store.
2. **Economic** - The influence of the economy as a whole on the business. For example, a rise in interest rates would always cause a decrease in sales of certain products.
3. **Social** - The influence of demographic composition and social norms. For example, the move to a different shopping centre saw a change in the type of customer even though they were in the same suburb.
4. **Technological** - The influence of progress in technology. For example, the internet enabled previous customers to purchase from overseas the same product at a cheaper price.
5. **Competitors** - The influence that competitors behaviour has on the business. For example, the large department stores started to stock the same items as the shop.

Internal Factors

1. **Profitable** - For a sustainable positive cash flow a business needs to be profitable.
2. **Debtors, stock and creditors** - Poor control of these three factors can cause major cash flow problems. They are the silent killers of cash flow. For example, when the shop moved into the larger premises the amount of stock doubled, this stock had been financed from the cash in the bank.
3. **Over capitalised** - The purchase of assets that are not producing a reasonable

return on investment will affect cash flow. For example, the new shop required new fixtures and fittings however there was no increase in revenue from this investment.

4. **Too high borrowings** - The business has borrowed too much and its loan repayments are causing cash flow problems.

5. **Taxation** - The business can encounter problems when it doesn't set aside money for income tax. Another problem is spending GST or VAT collected before remitting it to the tax department.

6. **Owners Drawings** - The owners of the business withdraw more cash out of the business than the business is generating.

7. **Unplanned or uncontrolled growth** - This can be one of the biggest causes of cash flow problems in small business. It results in overtrading, i.e. buying and selling more than the resources of the business can handle.

8. **Lack of planning** - Cash flow is all about timing. If a business is not prepared for large payments it will affect the cash flow.

9. **Poor quality financial information** - The lack of regular financial reports will cause poor decisions to be made.

10. **Poor internal controls** - Internal controls are procedures to safeguard the business's assets. For example, no procedure to follow up overdue customers

SESSION 4.

Calculate an approximate APR.

Learning Outcomes

- The concept of APR is explained with examples.
- An approximate APR is calculated for an organization from a given cash flow or Hire Purchase scheme in order to be able to compare rates and make finance choices.

Annual percentage rate

The term **annual percentage rate (APR)**, also called **nominal APR**, and the term **effective APR**, also called **EAPR**, describes the interest rate for a whole year (annualized), rather than just a monthly fee/rate, as applied on a loan, mortgage loan, credit card, etc. It is a finance charge expressed as an annual rate. Those terms have formal, legal definitions in some countries or legal jurisdictions, but in general:

- The *nominal APR* is the simple-interest rate (for a year).
- The *effective APR* is the fee compound rate (calculated across a year).

The nominal APR is calculated as: the rate, for a payment period, multiplied by the number of payment periods in a year. However, the exact legal definition of "effective APR", or EAR in short, can vary greatly in each jurisdiction, depending on the type of fees included, such as participation fees, loan origination fees, monthly service charges, or late fees. The effective APR has been called the "mathematically-true" interest rate for each year. The computation for the effective APR, as the fee compound rate, can also vary depending on whether the up-front fees, such as origination or participation fees, are added to the entire amount, or treated as a short-term loan due in the first payment. When start-up fees are paid as first payment(s), the balance due might accrue more interest, as being delayed by the extra payment period(s).

In some areas, the *annual percentage rate* (APR) is the simplified counterpart to the effective interest rate that the borrower will pay on a loan. When not using the term "effective APR", the use of "APR" is an early term for *nominal APR*. In many countries and jurisdictions, lenders (such as banks) are required to disclose the "cost" of borrowing in some standardized way as a form of consumer protection. APR is intended to make it easier to compare lenders and loan options. The APR is likely to differ from the "note rate" or "headline rate" advertised by the lender, due to the addition of other fees that may need to be included in the APR. APRs can be found by asking the lender or by reading the appropriate section in the contract.

In the U.S. and the UK, lenders are required to disclose the APR before the loan (or credit application) is finalized (although the definition of "APR" is not the same in the two countries). Credit card companies can advertise monthly interest rates, but they are required to clearly state the annual percentage rate before an agreement is signed. *APR* is a term used with regard to deposit accounts as well. However, when dealing with deposit accounts, the annual percentage yield (APY) or annual equivalent rate (AER) is quoted to consumers for comparison purposes.

Multiple definitions of effective APR

There are at least three ways of computing effective annual percentage rate:

- by compounding the interest rate for each year, without considering fees;
- origination fees are added to the balance due, and the total amount is treated as the basis for computing compound interest;
- The origination fees are amortized as a short-term loan. This loan is due in the first payment(s), and the unpaid balance is amortized as a second long-term loan. The extra first payment(s) is dedicated to primarily paying origination fees and interest charges on that portion.

For example, consider a R100 loan which must be repaid after one month, plus 5%, plus a R10 fee. If the fee is neglected, this loan has a (year-long) effective APR of approximately 80% ($1.05^{12} = 1.7958$). If the R10 fee were considered, the monthly interest increases by 10% (R10/R100), and the effective APR becomes approximately 435% ($1.15^{12} = 5.3502$, as 535%-100%=435%). Hence there are at least two possible "effective APRs": 79% and 435%. Laws vary as to whether fees must be included in APR calculations

- Confusion is possible in that if the word "effective" is used separately as meaning "influential" or having a "long-range effect", then the term *effective APR* will vary, as it is not a strict legal definition. The APR is used to find compound and simple interest rates.
- APR is also an abbreviation for "Annual Principal Rate" which is sometimes used in the auto sales where the interest is calculated based on the "Original Principal" not the "Current Principal Due", so as the Current Principal Due decreases, the interest due does not.

Rate format

An effective annual interest rate of 10% can also be expressed in several ways:

- 0.7974% effective monthly interest rate, because $1.007974^{12}=1.1$
- 9.569% annual interest rate compounded monthly, because 12×0.7974=9.569
- 9.091% annual rate in advance, because (1.1-1)÷1.1=0.091

These rates are all equivalent, but to a consumer who is not trained in the mathematics of finance, this can be confusing. APR helps to standardize how interest rates are compared, so that a 10% loan is not made to look cheaper by calling it a loan at "9.1% annually in advance".

The APR does not necessarily convey the total amount of interest paid over the course of a year: if one pays part of the interest prior to the end of the year, the total amount of interest paid is less.

In the case of a loan with no fees, the amortization schedule would be worked out by taking the principal left at the end of each month, multiplying by the monthly rate and then subtracting the monthly payment. This can be expressed mathematically by

$$p = \frac{P_0 \cdot r \cdot (1+r)^n}{(1+r)^n - 1}$$

where:

P_0 is the initial principal

r is the percentage rate used each payment

n is the number of payments

This also explains why a 15 year mortgage and a 30 year mortgage with the same APR would have different monthly payments and a different total amount of interest paid. There are many more periods over which to spread the principal, which makes the payment smaller, but there are just as many periods over which to charge interest at the same rate, which makes the total amount of interest paid much greater. For example, R100,000 mortgaged (without fees, since they add into the calculation in a different way) over 15 years costs a total of R193,429.80 (interest is 93.430% of principal), but over 30 years, costs a total of R315,925.20 (interest is 215.925% of principal).

In addition the APR takes costs into account. Suppose for instance that R100,000 is borrowed with R1000 one-time fees paid in advance. If, in the second case, equal monthly payments are made of R946.01 against 9.569% compounded monthly then it takes 240 months to pay the loan back. If the R1000 one-time fees are taken into account then the yearly interest rate paid is effectively equal to 10.31%.

The APR concept can also be applied to savings accounts: imagine a savings account with 1% costs at each withdrawal and again 9.569% interest compounded monthly. Suppose that the complete amount including the interest is withdrawn after exactly one year. Then, taking this 1% fee into account, the savings effectively earned 8.9% interest that year.

Money factor

The APR can also be represented by a **money factor** (also known as the lease factor, lease rate, or factor). The money factor is usually given as a decimal, for example .0030. To find the equivalent APR, the money factor is multiplied by 2400. A money factor of .0030 is equivalent to a monthly interest rate of 0.6% and an APR of 7.2%.

For a leasing arrangement with an initial capital cost of *C*, a residual value at the end of the lease of *F* and a monthly interest rate of *r*, monthly interest starts at *Cr* and decreases almost linearly during the term of the lease to a final value of *Fr*. The total amount of interest paid over the lease term of *N* months is therefore

$$\frac{N(Cr+Fr)}{2},$$

and the average interest amount per month is

$$\frac{(C+F)r}{2}.$$

This amount is called the "monthly finance fee". The factor *r*/2 is called the "money factor"

Module 2

LEARNER GUIDE

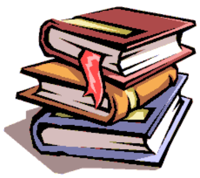
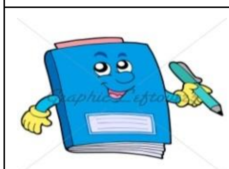
FINALISE AND INTERPRET ACCOUNTS

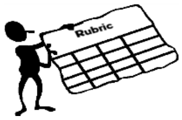
Learner Information:

Details	Please Complete this Section
Name & Surname:	
Organisation:	
Unit/Dept:	
Facilitator Name:	
Date Started:	
Date of Completion:	

Key to Icons

The following icons may be used in this Learner Guide to indicate specific functions:

 **Books**	**This icon means that other books are available for further information on a particular topic/subject.**
 **References**	**This icon refer to any examples, handouts, checklists, etc…**
 **Important**	**This icon represents important information related to a specific topic or section of the guide.**
 **Activities**	**This icon helps you to be prepared for the learning to follow or assist you to demonstrate understanding of module content. Shows transference of knowledge and skill.**
 **Exercises**	**This icon represents any exercise to be completed on a specific topic at home by you or in a group.**

 Tasks/Projects	An important aspect of the assessment process is proof of competence. This can be achieved by observation or a portfolio of evidence should be submitted in this regard.
 Workplace Activities	An important aspect of learning is through workplace experience. Activities with this icon can only be completed once a learner is in the workplace
 Tips	This icon indicates practical tips you can adopt in the future.
 Notes	This icon represents important notes you must remember as part of the learning process.

Learner Guide Introduction

About the Learner Guide…	This Learner Guide provides a comprehensive overview of the Perform Financial Planning and Control Functions for a Small Business, and forms part of a series of Learner Guides that have been developed for **National Certificate: Small Business Financial Management at NQF Level 4, worth 120 credits.** The series of Learner Guides are conceptualized in modular's format and developed **National Certificate: Small Business Financial Management Learning Programme.** They are designed to improve the skills and knowledge of learner, and thus enabling them to effectively and efficiently complete specific tasks. Learner are required to attend training workshops as a group or as specified by their organization. These workshops are presented in modules, and conducted by a qualified facilitator.
Purpose	The purpose of this Learner Guide is to provide learner with the necessary knowledge related to **Finalise and interpret accounts**
Assessment Criteria	The only way to establish whether a learner is competent and has accomplished the specific outcomes is through an assessment process. Assessment involves collecting and interpreting evidence about the learner's ability to perform a task.

	This guide may include assessments in the form of activities, assignments, tasks or projects, as well as workplace practical tasks. Learner are required to perform tasks on the job to collect enough and appropriate evidence for their portfolio of evidence, proof signed by their supervisor that the tasks were performed successfully.
To qualify	To qualify and receive credits towards the learning program, a registered assessor will conduct an evaluation and assessment of the learner's portfolio of evidence and competency
Range of Learning	This describes the situation and circumstance in which competence must be demonstrated and the parameter in which learner operate
Responsibility	The responsibility of learning rest with the learner, so: • Be proactive and ask questions, • Seek assistance and help from your facilitator, if required.

Learning Unit 1 FINALISE AND INTERPRET ACCOUNTS

UNIT STANDARD NUMBER	:	114741
LEVEL ON THE NQF	:	4
CREDITS	:	4
FIELD	:	Business, Commerce and Management Studies
SUB FIELD	:	Finance, Economics and Accounting

<table>
<tr><td>PURPOSE:</td><td>This Unit Standard is for people who are responsible for controlling the finances of a small business or who are responsible for the bookkeeping aspect of financial management in larger organisations.
Qualifying learner will be able to:
• Make adjustments to total expenses and purchases of assets
• Prepare a trading and profit and loss account and balance sheet for a small business
• Understand the distinctions between gross profit, net profit and cash in hand
• Be able to calculate and use basic liquidity and profitability ratios to assess the performance of a small business</td></tr>
<tr><td colspan="2">LEARNING ASSUMED TO BE IN PLACE:</td></tr>
<tr><td colspan="2">It is assumed that learner are competent in Communication, Mathematical Literacy and Accounting at NQF Level 3.</td></tr>
</table>

SESSION 1. Make adjustments to total expenses and purchases of assets.
Learning Outcomes
• The straight line and reducing balance methods of stock evaluation are understood and examples given of how each is used in an Organisation • Adjustments are made for stock evaluation, depreciation of fixed assets, pre-payments and bad debts of a small business using the straight line and reducing balance methods

The straight line and reducing balance methods of stock evaluation

In financial markets, stock valuation is the method of calculating theoretical values of companies and their stocks. The main use of these methods is to predict future market prices, or more generally potential market prices, and thus to profit from price movement – stocks that are judged undervalued (with respect to their theoretical value) are bought, while stocks that are judged overvalued are sold, in the expectation that undervalued stocks will, on the whole, rise in value, while overvalued stocks will, on the whole, fall.

Stock Valuation Methods

Stocks have two types of valuations. One is a value created using some type of cash flow, sales or fundamental earnings analysis. The other value is dictated by how much an investor is willing to pay for a particular share of stock and by how much other investor are willing to sell a stock for (in other words, by supply and demand). Both of these values change over time as investor change the way they analyze stocks and as they become more or less confident in the future of stocks.

The fundamental valuation is the valuation that people use to justify stock prices. The most common example of this type of valuation methodology is P/E ratio, which stands for Price to Earnings Ratio. This form of valuation is based on historic ratios and statistics and aims to assign value to a stock based on measurable attributes. This form of valuation is typically what drives long-term stock prices.

The other way stocks are valued is based on supply and demand. The more people that want to buy the stock, the higher its price will be. And conversely, the more people that want to sell the stock, the lower the price will be. This form of valuation is very hard to understand or predict, and it often drives the short-term stock market trends.

There are many different ways to value stocks. The key is to take each approach into account while formulating an overall opinion of the stock. If the valuation of a company is lower or higher than other similar stocks, then the next step would be to determine the reasons.

Stocks consist of all materials held for eventual resale, whether these be raw materials, work in progress or stocks of finished goods. The accounting standard SSAP 9 sets out that stocks should be valued at whichever is the lower of cost or net realisable values. The standard defines cost as 'that expenditure which has been incurred in the normal couRe of business in bringing the product or service to its present location and condition'.

For a trading business such as a retailer, cost will therefore be the purchase price plus the cost of delivery to the retail store. For a manufacturing business, the cost of finished goods will be the direct costs of labour, materials and expenses, and in addition will include factory overheads absorbed into the product. Net realizable value is the selling price of the stock less all further costs to be incurred before a sale is completed.

There are a number of ways of determining the cost of a stock item. Stock may be valued on a 'first-in first-out' or average cost basis, or a reasonable approximation of these. Depreciation is a measure of the wearing out, consumption or other reduction in the useful economic life of a fixed asset. The useful economic life is the period over which the present owner will derive economic benefits from its use. Residual value is the net realizable value of the asset at the end of its potential economic life, i.e. disposal proceeds less selling costs. Another helpful term is net book value which is the cost of an asset less the amount it has depreciated at a moment in time.

Net book value = original cost - accumulated depreciation to date.

Methods of calculating depreciation

THE STRAIGHT LINE METHOD

The most common methods of calculating depreciation are the straight-line method and the reducing balance method.

Using the straight-line method, the asset's value is depreciated in equal amounts over its economic life. This is calculated by:

Depreciation charge per year = Cost - residual value - Estimated life in year
For example, a taxi costing R40,000 with an estimated life of ten year and a R10,000 residual value would be depreciated as follows:

Depreciation charge per year = R40,000 - R10,000 divided by 10
= R3,000 per year

THE REDUCING BALANCE

The reducing balance method does not depreciate assets evenly over their useful economic life, but instead charges more for depreciation in the early year of an asset's life. The method is appropriate where the relative benefits of owning the asset reduce as the asset ages - e.g., motor vehicles, and computer. It is calculated by applying a percentage rate to the asset's net book value (i.e., cost less depreciation to date). Depreciation per year = net book value x depreciation rate.

Adjustments to total expenses and purchases of assets

In tax accounting, adjusted basis is the net cost of an asset after adjusting for various tax-related items.

Adjusted Basis or Adjusted Tax Basis refer to the original cost or other basis of property, reduced by depreciation deductions and increased by capital expenditures.

Example: Brad buys a lot for R100,000. He then erects a retail facility for R600,000, then depreciates the improvements for tax purposes at the rate of R15,000 per year. After three yeaR his adjusted tax basis is R655,000 [R100,000 + R600,000 - (3 x R15,000)].

Adjusted basis is one of two variables in the formula used to compute gains and losses when determining gross income for tax purposes. The Amount Realized – Adjusted Basis tells the amount of Realized Gain (if positive) or Realized Loss (if negative).

Calculation

Adjusted basis is calculated by beginning with an asset's original cost basis, and then making adjustments. Adjusted basis is calculated as follows:

- Purchase costs (title & escrow fees, broker commissions, shipping, sales tax, etc.)
- Improvements (rehabilitation expenses & substantial repair)
- Legal fees (to defend or to perfect title to the property, zoning costs, etc.)
- Selling costs (title & escrow fees, broker commissions, shipping, transfer fees, etc.)

Minus the costs represented by:

- Accumulated depreciation, depletion, or amortization
- Casualty or theft Loss
- Other decreases to basis

Adjusted basis is crucial for calculating capital gains and ordinary gains when an asset is sold.

A complete list of adjustments which increase or decrease basis is found in *IR* Publication 551, Basis of Assets.

The adjusted basis for tax purposes is different than for financial accounting (GAAP) gains or losses on sales of capital assets.

SESSION 2. Prepare a trading and profit and loss account and balance sheet for a small business
Learning Outcomes
• The reasons for preparing a trading account, a profit and loss account and a balance sheet for a small business are explained giving examples of the advantages and disadvantages for the business if they are not prepared • A trading account, a profit and loss account and a balance sheet are prepared for a small business using information from the financial records of the business

Why Is Trading Account Prepared?

The Trading Account is necessary because it has the following advantages.

Gross profit of a business is very important data, since all business expenses are met out of it. So, the amount of gross profit should be adequate to meet all the indirect expenses of a business.

The amount of net sale can be determined through this account. The success or failure of a business can be ascertained by comparing net sales of the current year with that of the last year. It should be noted that an increase in the number of net sales of the current year over the last year may not be regarded as a sign of success, since sales may increase because of rise in price level.

Percentage of gross profit on net sales can be easily determined from Trading A/C. This percentage is very important yardstick for measuring the success or failure of a business. Compared to last year, if the rate increases, it indicates success; on the other hand, if the rate decreases, it is an indication of failure.

Percentage of different items of buying expenses on gross profit can be easily determined and by comparing the percentage of the current year with that of the previous year the variations can be ascertained. An analysis of variances will disclose their causes which will help in controlling the amount of expenses.

What Are The Advantages Of Profit And Loss Account?

Profit and loss account is a statement of a company which shows the revenues and expenses incurred by the company during a specific period, generally one year. It shows the financial position of the company. Profit and loss statement of income statement is very important for any organization because it shows the total profit earned by the company throughout the year. For a listed company, the shareholder knows about their profits which they will by the distribution of the profit after tax. This statement is based on accrual accounting therefore, it matches revenues against expenses. Moreover, companies can analyze their expenses and different sources of revenue from this statement. Therefore, in order to determine the financial strength and profits of a company, profit and loss statement is considered very important.

Why Is balance sheet Prepared?

One of the most important financial documents of any business is the balance sheet. The balance sheet gives you a detailed picture of your company's financial position at a given point in time and can help you make wise financial decisions. Most of the accounting software we reviewed has a tool for managing your balance sheet.

The balance sheet is necessary for a number of reasons. Not only does it give you an immediate report on the current financial status of your company, it allows you to analyze trends to see where improvements can be made. The balance sheet gives critical information to potential lender, helping them to decide on a line of credit for your business.

What is the balance sheet? The balance sheet is simply a list of all of your company's equity, including assets and liabilities. An asset is anything that your company owns. There are two main types of assets. The type of asset is dependent upon the amount of time it takes to liquidate the assets into cash. Current assets can be liquidated very quickly.

These assets include cash, money accounts, and account receivables. Fixed assets, on the other hand, are harder to liquidate and take more time. These include land, buildings, equipment, etc. With the exception of land, most fixed assets depreciate in value. This depreciation must be figured into the total value of fixed assets. Any type of asset that does not fit into these two groups is placed in the "other" category. These assets include prepaid expenses that have value, but cannot be exchanged for cash.

Liabilities are anything that is owed by your company to someone outside of the company. There are two main types of liabilities. Current liabilities are liabilities that are due in a year or less. These include accounts payable and payroll. Long-term liabilities will take more than a year to pay off. These typically include leases and loans.

Equity is the difference between the assets and the liabilities. The equity includes your initial investment, which is usually the stockholder' money, as well as any money that is retained through business operations and is put back into your business. If the assets outweigh the liabilities, the equity will be positive and your business will be healthy. If the opposite is true, your business is losing money and adjustments need to be made.

The balance sheet is a necessary tool for your small business. It is proof of your financial status and can be consulted to help you make wise financial decisions that will aid in the growth of your small business.

Reasons companies prepare balance sheet
A balance sheet is a picture of a company's financial position as of a point in time. A balance sheet can be prepared as of any date, but it's usually prepared as of month, quarter or year-end. A balance sheet is a very valuable statement that provides information about financial health of a company. Things like cash, accounts receivable, accounts payable, net worth, etc. can be determined by looking at a balance sheet. There are multiple good reasons to prepare a balance sheet. First, you (as a business owner or a business manager) will want to know where your company stands in terms

of financial health at a point in time. Second, anybody interested in your company will want to see your balance sheet. Such interested parties may include the following:

- **Banks**: Financial institutions want to know if your company will be able to repay a loan when you apply for one.
- **Investors**: At some point one source of capital (your savings in the business) may not be sufficient to maintain a rapid growth. You may want to find investors who would like to invest in your company. Before inventors give you their money, though, they might want to see a balance sheet (and other financial statements) to ensure their investments won't go south in the future.
- **Authorities**: Some authorities might like to see a balance sheet of your business. A good example is the Internal Revenue Service (IRS).
- **Vendors**: Sometimes vendors ask for a balance sheet (and other financial statements) to understand if you will be able to settle your obligations. **Note**: Where possible, you should also ask for the vendors' financial statements to understand if your vendors will stay in business long enough to provide you with the products you buy from them.
- **Customers**: Similar to vendors, customers may sometimes ask for a balance sheet (and other financial statements) to understand if you will be able to stay in business to provide them with products or services you sell. For instance, from customers' standpoint, changing vendors may be time and resource-consuming; thus, customers want to analyze your balance sheet to make sure you will not go bankrupt in the near future. **Note**: Where possible, you should also ask for customers' financial statements to see if they will be able to pay for goods or services you provide.

Illustration: Balance sheet template

Your Company Name Trial Balance December 31, 20X0		
ASSETS		
Current Assets:		
Cash & Cash Equivalents		
Marketable Securities		
Accounts Receivable		
Inventories		
Prepaid Expenses		
Total Current Assets		
Fixed Assets		
Intangible Assets		
Investments		
Other Non-current Assets		
TOTAL ASSETS		
LIABILITIES		
Current Liabilities:		
Accounts Payable		
Accrued Expenses		
Short-term Loans		
Current Portion of LT Debt		
Income Taxes Payable		
Total Current Liabilities		
Non-current Liabilities:		
Line of Credit		
Term Loan		
Total Non-current Liabilities		
TOTAL LIABILITIES		
EQUITY		
Capital		
Current Year Earnings		

Your Company Name Trial Balance December 31, 20X0		
Retained Earnings		
TOTAL EQUITY		
TOTAL LIABILITIES & EQUITY		

Illustration » Problem

To get an understanding and feel of the process of final accounting, let us go through an example of an organizations accounting consisting of a few transactions during an accounting period.

Following are the transactions relating to M/s Trinity Foods, over an accounting period from 1st June 2005 to 30th June 2006.

- Started business with Capital R. 1,00,000
- Paid into Bank R. 10,000
- Bought Furniture and paid cash R. 25,000
- Bought goods for cash R. 50,000
- Bought goods from Ram on Credit R. 15,000
- Sold a part of the goods for R. 75,000 and paid the proceeds into bank directly
- Sold the remaining goods on credit for R. 50,000 to Rahim
- Paid Salaries and Wages R. 5,000
- Paid rent by cheque R. 8,000

Illustration » Solution [Trial Balance]

The trial balance is nothing but a statement of ledger account balances as on a particular instance.

Trial Balance of M/s Trinity Foods" as on 30th June 2005			
Particular	**L/F**	**Debit Amount (in R)**	**Credit Amount (in R)**
Cash a/c	—	10,000	
Capital a/c	—		
Bank a/c	—	77,000	
Furniture a/c	—	25,000	1,00,000
Purchases a/c	—	65,000	
Ram a/c	—		
Sales a/c	—		
Rahim a/c	—	50,000	15,000
Salaries and Wages a/c	—	5,000	1,25,000
Rent Paid a/c	—	8,000	
Total		2,40,000	2,40,000

Preparing Trading and Profit and Loss Account: Journal & Ledger

Consider the above Trial Balance. There are a total of 4 nominal accounts with either debit or credit balances.

- Purchases a/c [Debit Balance]
- Sales a/c [Credit Balance]
- Salaries and Wages a/c [Debit Balance]
- Rent Paid a/c [Debit Balance]

To ascertain the profit or loss made by the Organisation, the balance in these accounts should be transferred to the "Trading and Profit & Loss a/c". The journal entries for these transfers would be:

Journal Entries

Journal in the books of M/s Trinity Foods for the period from 1st June 2005 to 30th June 2005

Date	V/R No.	Particulars		L/F	Debit Amount (in Rs)	Credit Amount (in Rs)
June 30th	–	Trading and Profit & Loss a/c	Dr	–	78,000	
		To Purchases a/c		–		65,000
		To Salaries & Wages a/c		–		5,000
		To Rent Paid a/c		–		8,000
		[For the transfer of debit balances in nominal accounts at the end of the accounting period to the Trading and Profit & Loss a/c for the purpose of ascertaining profits.]				
June 30th	–	Sales a/c	Dr	–	1,25,000	
		To Trading and Profit & Loss a/c		–		1,25,000
		[For the transfer of credit balances in nominal accounts at the end of the accounting period to the Trading and Profit & Loss a/c for the purpose of ascertaining profits.]				

Trading and Profit & Loss a/c

The "Trading and Profit & Loss a/c" would be

Dr Trading and Profit & Loss a/c Cr

Date	Particulars	J/F	Amount (in Rs)	Date	Particulars	J/F	Amount (in Rs)
30/06/05	To Purchases a/c	–	65,000	30/06/05	By Sales a/c	–	1,25,000
"	To Salaries &	–	5,000				
"		–	8,000				

	Wages a/c To Rent Paid a/c						
	sub-total		78,000		**sub-total**		1,25,000
30/06/05	To Bal (Profit)	–	47,000				
	Total		1,25,000		**Total**		1,25,000

Since the credit side total is greater, the account has a credit balance. Since a credit balance in a nominal account indicates a gain, we can say that there is a profit.

SESSION 3. Understand the distinctions between gross profit, net profit and cash in hand
Learning Outcomes
• The differences between gross and net profit and cash in hand are known and explained using examples from a small business • The significance of these distinctions is explained for a business

Gross and net profit and cash in hand

Gross Income for Consumers: This refers to the total personal income before taxes, allowances, and tax deductions are taken into account. Gross income includes the following items: wages, salary, tips, taxable interest, ordinary dividends, capital gains (losses), taxable amount of IRA distributions, taxable amount of pensions and annuities, business income, alimony received, unemployment compensation received, rental income from real estate, income from royalties, trusts, taxable refunds and taxable amount of Social Security benefits. It's important to note that gross income does not include the tax-free amount of Social Security benefits, gifts and inheritance, [and interest from tax-free bonds.

Gross Income for Corporates: It is referred to as gross profit. It is computed by subtracting the cost of goods sold from the revenue that is generated. In other words --

☛ Gross Profit = Sales x Cost per Unit of Sales - Cost of Goods Sold

Net Income for Consumers: Popularly known as Adjusted Gross Income (AGI). It is computed by deducting the following items from Gross Income: IRA contributions, interest paid on student loans, 50% of self-employment tax, moving expenses, contributions for health insurance made by the self-employed, alimony payments, penalties for early withdrawal of savings, contributions to Simplified Employee Pension plan and SIMPLE IRA, contributions to other qualified retirement plans and deductions for MSA (Archer Medical Savings Accounts). AGI is used to determine the individual's tax bracket, qualifying credits, and allowable contribution limits for tax-deferred retirement accounts. Federal income tax liability for individuals is arrived at by subtracting itemized deductions from adjusted gross income (net income). These deductions include expenses, such as mortgage interest, medical expenses, charitable contributions, local and state taxes, gifts, real estate taxes, etc.

☛ Net Income before Tax = Sales - Cost of Goods Sold - Operating Expenses - Non-cash Operating Expenses + Non-Operating Income - Non-Operating Expenses

Net Income after Tax = Net Income before Tax – Taxes

Degree of Importance

The distinction between gross and net income becomes important for consumers, who are interested in availing home mortgage for buying a house. It's not advisable for consumers to spend more than 33% of their monthly gross income on mortgage payments. If they find themselves in the situation of paying more than the recommended figure, they should consider alternative arrangements, like renting. Again, car loans repayments should ideally be 8%, but in no case should they exceed 11% of gross monthly income.

Companies pay a portion of the net income after taxes as dividends to consumers, while retaining the rest. Retained earnings are generally greater for companies that have growth prospects. Companies in the mature growth phase prefer paying out most of their net income after taxes as dividends to shareholders. Information about past earnings and dividends is useful for investors, who are interested in receiving dividend income as well as those interested in capital appreciation.

While calculating gross and net income, you are subsequently acquainted with the expenses incurred accompanied by various dimensions of the business, so that the lucrative and potentially profitable aspects of the business are stimulated to facilitate growth. Make sure that both figures -- gross and net income -- must feature on the federal tax return. Where inviting investors is the considered proposition, ready your income statement, as they would like to scour the same, ere investing. However, if you have filed a loan application to fulfill ad hoc commitments, the institution that considers granting the sum to you, verifies the documents with regard to your gross income and net income statement. It is only, when the entire verification process is deemed satisfactory that the loan is sanctioned.

It is evident from the above discussion that computation of gross income vs. net income is important for consumers as well as companies. Although, the computation seems complex, consumers will be delighted to know that gross income and AGI calculators are available on the internet.

In accounting, **gross profit** or **sales profit** is the difference between revenue and the cost of making a product or providing a service, before deducting overhead, payroll, taxation, and interest payments. Note that this is different from operating profit (earnings before interest and taxes).

The various deductions (and their corresponding metrics) leading from Net sales to Net income are as follow:

Net sales = Gross sales - (Customer Discounts, Returns, Allowances)

Gross profit = Net sales - Cost of goods sold

Operating Profit = Gross Profit - Total operating expenses

Net income (or Net profit) = Operating Profit – taxes – interest

(Note: cost of goods sold is calculated differently for a merchandising business than for a manufacturer.)

SESSION 4. **Calculate and use basic liquidity and profitability ratios**
Learning Outcomes
• Ratio calculations are made in respect of profitability and liquidity for a small business • The performance of a business is appraised and commented on following a ratio and liquidity analysis • The limitations of ratio analysis for assessing the current and future potential performance is understood for a business

Basic liquidity and profitability ratios

A financial ratio (or accounting ratio) is a relative magnitude of two selected numerical values taken from an enterprise's financial statements. Often used in accounting, there are many standard ratios used to try to evaluate the overall financial condition of a corporation or other organization. Financial ratios may be used by managers within a firm, by current and potential shareholders (owners) of a firm, and by a firm's creditors. Financial analysts use financial ratios to compare the strengths and weaknesses in various companies. If shares in a company are traded in a financial market, the market price of the shares is used in certain financial ratios.

Ratios can be expressed as a decimal value, such as 0.10, or given as an equivalent percent value, such as 10%. Some ratios are usually quoted as percentages, especially ratios that are usually or always less than 1, such as earnings yield, while others are usually quoted as decimal numbers, especially ratios that are usually more than 1, such as P/E ratio; these latter are also called multiples. Given any ratio, one can take its reciprocal; if the ratio was above 1, the reciprocal will be below 1, and conversely. The reciprocal expresses the same information, but may be more understandable: for instance, the earnings yield can be compared with bond yields, while the P/E ratio cannot be: for example, a P/E ratio of 20 corresponds to an earnings yield of 5%

Sources of data for financial ratios

Values used in calculating financial ratios are taken from the balance sheet, income statement, statement of cash flows or (sometimes) the statement of retained earnings. These comprise the firm's "accounting statements" or financial statements. The statements' data is based on the accounting method and accounting standards used by the organization.

Purpose and types of ratios

Financial ratios quantify many aspects of a business and are an integral part of the financial statement analysis. Financial ratios are categorized according to the financial aspect of the business which the ratio measures. **Liquidity ratios** measure the availability of cash to pay debt. **Activity ratios** measure how quickly a firm converts non-cash assets to cash assets. **Debt ratios** measure the firm's ability to repay long-term debt. **Profitability ratios** measure the firm's use of its assets and control of its expenses to generate an acceptable rate of return. **Market ratios** measure investor response to owning a company's stock and also the cost of issuing stock. These are concerned with the return on investment for shareholders, and with the relationship between return and the value of an investment in company’s shares.

Financial ratios allow for comparisons

- between companies
- between industries
- between different time periods for one company
- between a single company and its industry average

Ratios generally are not useful unless they are benchmarked against something else, like past performance or another company. Thus, the ratios of firms in different industries, which face different risks, capital requirements, and competition are usually hard to compare.

Profitability ratios

Profitability ratios measure the company's use of its assets and control of its expenses to generate an acceptable rate of return

Gross margin, Gross profit margin or Gross Profit Rate

$$\frac{\text{Gross Profit}}{\text{Net Sales}}$$

OR

$$\frac{\text{Net Sales} - \text{COGS}}{\text{Net Sales}}$$

Operating margin, Operating Income Margin, Operating profit margin or Return on sales (ROS)

$$\frac{\text{Operating Income}}{\text{Net Sales}}$$

Note: Operating income is the difference between operating revenues and operating expenses, but it is also sometimes used as a synonym for EBIT and operating profit. This is true if the firm has no non-operating income. (Earnings before interest and taxes / Sales.

Profit margin, net margin or net profit margin.

$$\frac{\text{Net Profit}}{\text{Net Sales}}$$

Return on equity (ROE)

$$\frac{\text{Net Income}}{\text{Average Shareholders Equity}}$$

Return on assets (ROA ratio or Du Pont Ratio)

$$\frac{\text{Net Income}}{\text{Average Total Assets}}$$

Return on assets (ROA)

$$\frac{\text{Net Income}}{\text{Total Assets}}$$

Return on assets Du Pont (ROA Du Pont)

$$\left(\frac{\text{Net Income}}{\text{Net Sales}}\right)\left(\frac{\text{Net Sales}}{\text{Total Assets}}\right)$$

Return on Equity Du Pont (ROE Du Pont)

$$\left(\frac{\text{Net Income}}{\text{Net Sales}}\right)\left(\frac{\text{Net Sales}}{\text{Average Assets}}\right)\left(\frac{\text{Average Assets}}{\text{Average Equity}}\right)$$

Return on net assets (RONA)

$$\frac{\text{Net Income}}{\text{Fixed Assets} + \text{Working Capital}}$$

Return on capital (ROC)

$$\frac{\text{EBIT}(1 - \text{Tax Rate})}{\text{Invested Capital}}$$

Risk adjusted return on capital (RAROC)

$$\frac{\text{Expected Return}}{\text{Economic Capital}}$$

OR

$$\frac{\text{Expected Return}}{\text{Value at Risk}}$$

Return on capital employed (ROCE)

$$\frac{\text{EBIT}}{\text{Capital Employed}}$$

Note: this is somewhat similar to (ROI), which calculates Net Income per Owner's Equity

Cash flow return on investment (CFROI)

$$\frac{\text{Cash Flow}}{\text{Market Recapitalisation}}$$

Efficiency ratio

$$\frac{\text{Non-Interest expense}}{\text{Revenue}}$$

Net gearing

$$\frac{\text{Net debt}}{\text{Equity}}$$

Basic Earnings Power Ratio

$$\frac{\text{EBIT}}{\text{Total Assets}}$$

Liquidity ratios

Liquidity ratios measure the availability of cash to pay debt.

Current ratio (Working Capital Ratio)

$$\frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Acid-test ratio (Quick ratio)

$$\frac{\text{Current Assets} - (\text{Inventories} + \text{Prepayments})}{\text{Current Liabilities}}$$

Cash ratio

$$\frac{\text{Cash and Marketable Securities}}{\text{Current Liabilities}}$$

Operation cash flow ratio

$$\frac{\text{Operating Cash Flow}}{\text{Total Debts}}$$

Advantages and Limitations of Ratio Analysis

Financial ratio analysis is a useful tool for users of financial statement. It has following advantages:

Advantages

- It simplifies the financial statements.
- It helps in comparing companies of different size with each other.
- It helps in trend analysis which involves comparing a single company over a period.
- It highlights important information in simple form quickly. A user can judge a company by just looking at few numbers instead of reading the whole financial statements.

Limitations

- Despite usefulness, financial ratio analysis has some disadvantages. Some key demerits of financial ratio analysis are:
- Different companies operate in different industries each having different environmental conditions such as regulation, market structure, etc. Such factors are so significant that a comparison of two companies from different industries might be misleading.

  Financial accounting information is affected by estimates and assumptions. Accounting standards allow different accounting policies, which impairs comparability and hence ratio analysis is less useful in such situations.
- Ratio analysis explains relationships between past information while users are more concerned about current and future information.

Module 3

LEARNER GUIDE

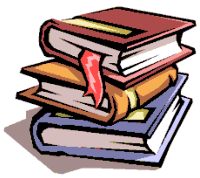
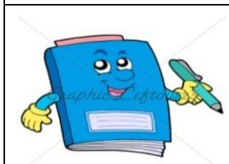
Cost and Price a Product

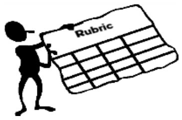
Learner Information:

Details	Please Complete this Section
Name & Surname:	
Organisation:	
Unit/Dept:	
Facilitator Name:	
Date Started:	
Date of Completion:	

Key to Icons

The following icons may be used in this Learner Guide to indicate specific functions:

 **Books**	**This icon means that other books are available for further information on a particular topic/subject.**
 **References**	**This icon refers to any examples, handouts, checklists, etc…**
 **Important**	**This icon represents important information related to a specific topic or section of the guide.**
 **Activities**	**This icon helps you to be prepared for the learning to follow or assist you to demonstrate understanding of module content. Shows transference of knowledge and skill.**
 **Exercises**	**This icon represents any exercise to be completed on a specific topic at home by you or in a group.**

<table>
<tr><td>
Tasks/Projects</td><td>An important aspect of the assessment process is proof of competence. This can be achieved by observation or a portfolio of evidence should be submitted in this regard.</td></tr>
<tr><td>
Workplace Activities</td><td>An important aspect of learning is through workplace experience. Activities with this icon can only be completed once a learner is in the workplace</td></tr>
<tr><td>
Tips</td><td>This icon indicates practical tips you can adopt in the future.</td></tr>
<tr><td>
Notes</td><td>This icon represents important notes you must remember as part of the learning process.</td></tr>
</table>

Learner Guide Introduction

About the Learner Guide…	This Learner Guide provides a comprehensive overview of the **Cost and Price a Product,** and forms part of a series of Learner Guides that have been developed for **NATIONAL CERTIFICATE: SMALL BUSINESS FINANCIAL MANAGEMENT at NQF Level 5, worth 145 credits** The series of Learner Guides are conceptualized in modular's format and developed **NATIONAL CERTIFICATE: SMALL BUSINESS FINANCIAL MANAGEMENT Learning Programme.** They are designed to improve the skills and knowledge of learners, and thus enabling them to effectively and efficiently complete specific tasks. Learners are required to attend training workshops as a group or as specified by their organization. These workshops are presented in modules, and conducted by a qualified facilitator.
Purpose	The purpose of this Learner Guide is to provide learners with the necessary knowledge related to **Cost and Price a Product**
Assessment Criteria	The only way to establish whether a learner is competent and has accomplished the specific outcomes is through an assessment process. Assessment involves collecting and interpreting evidence about the learner's ability to perform a task. This guide may include assessments in the form of activities, assignments, tasks or projects, as well as workplace

	practical tasks. Learners are required to perform tasks on the job to collect enough and appropriate evidence for their portfolio of evidence, proof signed by their supervisor that the tasks were performed successfully.
To qualify	To qualify and receive credits towards the learning program, a registered assessor will conduct an evaluation and assessment of the learner's portfolio of evidence and competency
Range of Learning	This describes the situation and circumstance in which competence must be demonstrated and the parameters in which learners operate
Responsibility	The responsibility of learning rest with the learner, so: • Be proactive and ask questions, • Seek assistance and help from your facilitators, if required.

Learning Unit 1 Cost and Price a Product

UNIT STANDARD NUMBER	:	114737
LEVEL ON THE NQF	:	5
CREDITS	:	6
FIELD	:	Business, Commerce and Management Studies
SUB FIELD	:	Finance, Economics and Accounting

PURPOSE:	This Unit Standard is for people who are responsible for controlling the finances of a small business or who are responsible for the bookkeeping aspect of financial management in larger organisations. Qualifying learners will be able to: Calculate the total costs involved in producing a product Distinguish between fixed and variable costs Carry out a break-even analysis Know how to calculate the selling price of a product.
LEARNING ASSUMED TO BE IN PLACE:	
It is assumed that learners are competent in Communication, Mathematical Literacy and Accounting at NQF Level 3.	

SESSION 1. Calculate the total production, administration, selling and distribution costs of a product.
Learning Outcomes
• The costs involved in producing a product are identified, including the apportionment of overheads • The total production cost of a product is calculated using all available information.

Calculate the total production, administration, selling and distribution costs of a product.

Administration costs usually include the costs of all the services related indirectly to production, for example:

- Quality Control Laboratories
- Medical and Hospital Service
- Security (e.g., premises, stored goods)
- Cafeteria
- Administration: Salaries and General Expenses
- Communications and Transport within the Plant
- Safety (in working places)
- Legal Advice
- Audits
- Recall Service (large firms)

Sale and distribution costs

- This component usually includes:
- Salaries and General Expenses in Sales Offices
- Salaries, Commissions and Travel Expenses for Employees in Sales Department
- Shipping and Transport Expenses
- Extra Expenses associated with Sales

- Technical Services for Sales
- Preparation and Shipment of Samples to Potential Purchasers
- Participation in Fairs
- Promotion Costs in General

Selling and Distribution Costs

If full and stable employment for men and machines is to be attained, with corresponding prospect of optimum profitability, it is essential to secure a steady and adequate volume of orders. In some industries goods are normally produced against specific orders; in others, they are manufactured in the expectation that they can and will be sold subsequently. In both cases, it is essential that, within the businesses, there should be detailed knowledge of the ultimate uses to which the products will be put by the final consumers, so that design and manufacture may be of fully satisfactory standard, and so that potential developments and changes of use may be foreseen and provided for. Somebody in the business must also know who these users ate, what other potential users there may be, and, if they are a large class of people, he, must know through what intermediaries, either retail; wholesale, or both, their custom can best be obtained.

Total Product: This is the total quantity of output produced by a firm for a given quantity of inputs. Total product is the foundation upon which the analysis of short-run production for a firm is based. It also provides the basis for calculating average product. If, for example, Waldo's TexMex Taco World has a staff of 5 that generates a total product of 110 tacos, then average product is 22 tacos.

The costs involved in producing a product are identified, including the apportionment of overheads

Manufacturing Costs:

Definition and Explanation of manufacturing cost:

Manufacturing costs are those costs that are directly involved in manufacturing of products and services. Examples of manufacturing costs include raw materials costs and salary of labor workers. Manufacturing cost is divided into three broad categories by most companies.

Manufacturing Overhead Cost:

Manufacturing overhead, the third element of manufacturing cost, includes all costs of manufacturing except direct material and direct labour. Examples of manufacturing overhead include items such as indirect material, indirect labour, maintenance and repairs on production equipment and heat and light, property taxes, depreciation, and insurance on manufacturing facilities. Indirect materials are minor items such as solder and glue in manufacturing industries. These are not included in direct materials costs. Indirect labour is a labour cost that cannot be trace to the creation of products or that can be traced only at great cost and inconvenience. Indirect includes the labour cost of janitors, supervisors, materials handlers and night security guards. Costs incurred for heat and light, property taxes, insurance, depreciation and so forth associated with selling and administrative functions are not included in manufacturing overhead. Studies have found that manufacturing overhead averages about 16% of sales revenue. Manufacturing overhead is known by various names, such as indirect manufacturing cost, factory overhead, and factory burden. All of these terms are synonymous with manufacturing overhead.

Manufacturing overhead cost combined with direct labour is called conversion cost.

Overhead Cost

Overhead cost consists of numerous types of expenses ranging from depreciation and taxes to various kinds of supplies. Because it is such a miscellaneous collection of costs, accountants spread this total lump of costs across products made to assign a portion of overhead costs to each unit produced.

In companies that run their cost systems primarily to generate unit costs for external reporting, accountants must estimate the total annual overhead at the start of the year. Usually they divide this total estimated overhead by the estimated number of labour hours the company will use during the year. The resulting value is called an **overhead rate** per labour hour, and accountants multiply this rate by the number of labour hours in a product to assign overhead cost to the product. Remember, accountants perform this calculation only because financial reporting rules require them to do so. This has no relevance for decision making.

Assume in the paint spraying example that accountants estimated at the start of the year that total overhead would equal $820,000 and that the company would use 100,000 labour hours. This provides an overhead rate of $8.20 per labour hour. Putting the material, labour and overhead costs together provide a **unit cost for external reporting** of $548. This $548 value appears in the balance sheet and income statement issued to creditors, investors and taxing authorities.

The total production cost of a product is calculated using all available information.

How to Calculate the Total Cost of a Product

In business, profitability occurs when revenue exceeds expenses. Using the total cost of a product to calculate expenses gives you a more accurate picture of profitability. The total cost of a product takes into account a wide range of expenses, including all fixed and variable costs associated with producing the product.

- Determine the accounting period for your calculations. To calculate your monthly total product cost, add the total fixed and variable costs for the month (that is, costs that represent a constant value and costs that fluctuate, respectively). If you want to determine annual product cost, add the total fixed and variable costs for the year.
- Compute the sum of all fixed costs associated with the product. Fixed costs exist even if a business does not produce any goods, and they remain constant regardless of the number of units produced. Overhead items represent the most common fixed costs and include all items associated with running the business. Example overhead costs include rent, utility payments and insurance premiums. Other potential fixed costs include equipment costs and depreciation. Identify these expenditures within the business accounting records and add the items to determine the total fixed costs.
- Compute the sum of all variable costs associated with the product. These costs can vary depending on how many units your business produces. Direct labour and material costs constitute the most common variable costs associated with an item. "Direct labour" refers to the wages paid to workers directly involved with the item's production. Add the labour and material costs to determine the total variable costs.
- Calculate the total cost of all products by adding the total fixed and total variable costs. This sum represents the total cost of all units produced.

How to Calculate Production Cost

- Understand the cost of production formula. The formula is fixed costs (FC) + variable costs (VC) divided by number of units = production cost per item.
- Determine your fixed costs. These are the costs that do not change based on the number of products produced. For instance, the rent you pay for your building, employees' salaries and utility costs are all fixed costs.
- Calculate your variable costs, i.e., the costs associated with making your product that change based on the quantity of the product produced. For instance, if you are making a cake from scratch, some of the variable costs would be the eggs, flour and sugar.
- Add your fixed costs to the variable costs and divide by the number of items produced; this equals your cost of production for one item. The price you are charging for your product will need to be greater than the cost of production; otherwise, your business will be operating at a loss.

SESSION 2.

Distinguish between fixed and variable costs.

Learning Outcomes

- The differences between fixed and variable costs is explained using examples of each.
- The factors increasing or decreasing variable costs are explained with examples.
- Ways in which the variable costs associated with the production of a particular product by an organization can be reduced are identified and an explanation given of the advantages and disadvantages of implementing each

Distinguish between fixed and variable costs.

Fixed Costs: These are those costs which remain fixed up to certain range of work capacity no matter how much product you produce within that capacity range. Like factory building rent. You pay the rent no matter that did you use that building for making the products or not.

Variable Costs: These are those costs which change with the change in the number of product units you produce. Like Material, Labor etc.

Fixed costs: are expenses whose total does not change in proportion to the activity of a business, within the relevant time period. For example, a retailer must pay rent and utility bills irrespective of sales

Variable costs: by contrast change in relation to the activity of a business such as sales or production volume. In the example of the retailer, variable costs may primarily be composed of inventory (goods purchased for sale), and the cost of goods is therefore almost entirely variable. In manufacturing, direct material costs are an example of a variable cost.

Along with variable costs, fixed costs make up one of the two components of total cost. In the most simple production function, total cost is equal to fixed costs plus variable costs.

The amount of fixed cost remains constants irrespective of the production volume. This is the cost for setting up facilities and for providing other infrastructure support for manufacturing even one unit of the product, but does not increase with the level of production. For example a company must pay rent for its factory and charge depreciation for the machinery it has installed irrespective of the quantity manufactured. Similarly the company may incur fixed costs on account of other expenses like salary paid to supervisory and managerial personnel.

The amount of variable cost incurred by a company varies directly in proportion to the volume of production. For example the volume of raw material consumed, and therefore raw material costs, incurred by a company vary directly with the production volume.

The differences between fixed and variable costs

Fixed costs are those costs which do not vary with volume of output and hence fixed are defined in terms of time like per day, or per month, or per year. So for example if fixed cost of a company is $2000 then if company produce whether 500 units or 1000 units total fixed cost will remain same but cost per unit will be $4 if company produces 500 units and $2 if company produces 1000 units. Fixed costs examples are salary of supervisors, rent, taxes etc….

Variable costs are those costs that changes directly with the production and hence they are defined in terms of units. So for example if direct material cost is $2 per unit and if company produces 500 units then total cost will be $1000 and if company produces 1000 units then cost will be $2000. Examples of variable cost are direct labour, depreciation on machinery, factory power etc.

Well, as name states itself, a fixed cost is a cost that an organisation has to bear whether it produces something or not but on the other hand, the variable cost is that cost which varies with the production level.

For Example, in its first year, a manufacturing company is producing 100 units of a product and the fixed cost they have to bear is Rs.10, 000 and the variable cost is Rs.20 per unit then the cost will be:

FC - 10,000

VC - 20,000

For second year it produces 90 units, and then the costs will be:

VC - 18,000

FC - 10,000

FC has not direct link with production but the VC does have.

Variable Costs

Variable costs are those costs which vary directly with the level of output. They represent payment output-related inputs such as raw materials, direct labour, fuel and revenue-related costs such as commission.

A distinction is often made between **"Direct"** variable costs and **"Indirect"** variable costs.

Direct variable costs are those which can be directly attributable to the production of a particular product or service and allocated to a particular cost centre. Raw materials and the wages those working on the production line are good examples.

Indirect variable costs cannot be directly attributable to production but they do vary with output. These include depreciation (where it is calculated related to output - e.g. machine hours), maintenance and certain labour costs.

Examples of fixed costs:

- Rent and rates
- Depreciation
- Research and development
- Marketing costs (non- revenue related)
- Administration costs

The factors increasing or decreasing variable costs.

The costs you incur directly in producing or buying the products and services you sell. We call these **VARIABLE COSTS** because they increase or decrease as your sales increase or decrease.

Variable Costs Increase - increased variable costs should lead to or be a result of improved product or service quality. The market would have to accept a higher price, or the improved product would have to attract enough new customers to offset the increase in variable costs.

Variable Costs Decrease - the sales volume would have to remain unchanged. The decrease in variable costs could not be allowed to affect product or service quality - which would have a negative effect on sales volumes. If sales did decline, the fall in gross revenues would have to be less than the decrease in variable costs.

Ways in which the variable costs associated with the production of a particular product by an organization can be reduced

SESSION 3.

Carry out simple break-even analysis.

Learning Outcomes

- The concept of break-even for a small business is explained with examples
- The necessary sales volumes to reach break-even for an organisation are calculated using total cost of production.
- Break-even analysis is used to make investment, pricing and purchasing decisions.

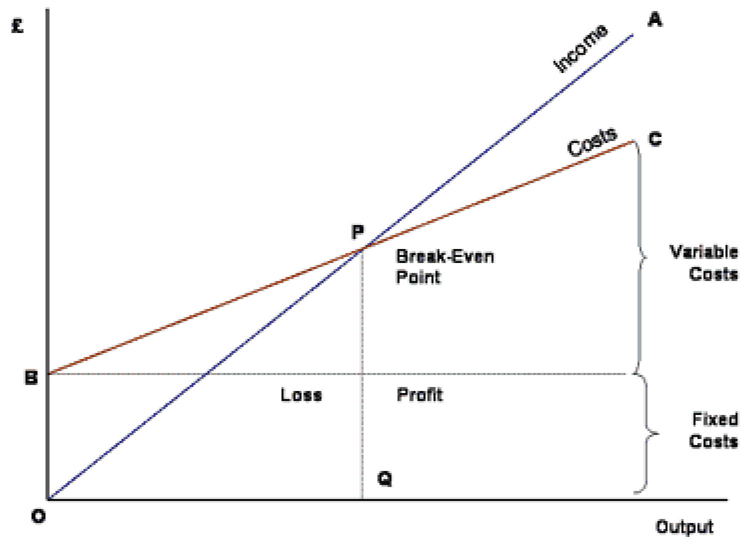
Carry out simple break-even analysis.

Break-even analysis is a technique widely used by production management and management accountants. It is based on categorizing production costs between those which are "variable" (costs that change when the production output changes) and those that are "fixed" (costs not directly related to the volume of production).

Total variable and fixed costs are compared with sales revenue in order to determine the **level of sales volume, sales value or production at which the business makes neither a profit nor a loss (the "break-even point").**

The Break-Even Chart

In its simplest form, the break-even chart is a graphical representation of costs at various levels of activity shown on the same chart as the variation of income (or sales, revenue) with the same variation in activity. The point at which neither profit nor loss is made is known as the "break-even point" and is represented on the chart below by the intersection of the two lines:



Break-even analysis typically compares revenues to costs. However, other models employ similar analysis.

In the crossover chart, the analyst graphs total-cost lines from two or more options. These choices may include alternative equipment choices or location choices. The only data needed are fixed and variable costs of each option. In Figure 2, the total costs (variable and fixed costs) for three options are graphed. Option A has the low-cost advantage when output ranges between zero and *X* units, whereas Option B is the least-cost alternative between *X* and *X* units of output. Above *X* units, Option
C will cost less than either A or B. This analysis forces the manager to focus on the relevant range of demand for the product, while allowing for sensitivity analysis. If current demand is slightly less than *X*, Option B would appear to be the best choice. However, if medium-term forecasts indicate that demand will continue to grow, Option C might be the least-cost choice for equipment expected to last several years. To determine the quantity at which Option B wrests the advantage from Option A, the manager sets the total cost of A equal to the total cost of B ($F_A + V_A \div Q = F_B + V_B \div Q$) solves for the sole quantity and that output of (Q) will make this equation true. Finding the break-even point between Options B and C follows similar logic.
The Economic Order Quantity (EOQ) model attempts to determine the least-total-cost quantity in the purchase of goods or materials. In this model, the total of ordering and

holding costs is minimized at the quantity where the total ordering cost and total holding cost are equal (i.e., the break-even point between these two costs).

The concept of break-even for a small business

Break-even analysis is used in cost accounting and capital budgeting to evaluate projects or product lines in terms of their volume and profitability relationship. At its simplest, the tool is used as its name suggests: to determine the volume at which a company's costs will exactly equal its revenues, therefore resulting in net income of zero, or the "break-even" point. Perhaps more useful than this simple determination, however, is the understanding gained through such analysis of the variable and fixed nature of certain costs. Break-even analysis forces the **small business** owner to research, **quantify**, and categorize the company's costs into fixed and variable groups. Break-even analysis has numerous potential applications for small businesses. For example, it can help managers assess the effect of changing prices, sales volume, and costs on profits. It can also help small business owners make decisions regarding whether to expand their operations or hire new employees. Break-even analysis would also be useful in the following situation: a small business owner is skeptical of her marketing manager's projection for sales of 15,000 units of a new product, and wants to know what minimum quantity of units must be sold to avoid losing money, assuming a selling price of $25, fixed costs of $100,000, and variable costs of $15. The equation tells her that these parameters will require a break-even volume of 10,000 units; less than that level yields losses, more than that level yields profits. This perspective of analysis may be employed where the analyst is highly confident of the estimates for price and costs, but feels less certain about the assessment of market demand. In this case, the small business owner might be interested in how low sales could fall below the marketing manager's forecast without causing an embarrassment at year-end reporting time.

The basic formula for break-even analysis is as follows:

- BEQ FC /(P-VC)
- Where BEQ Break-even quantity
- FC Total fixed costs
- P Average price per unit, and
- VC Variable costs per unit

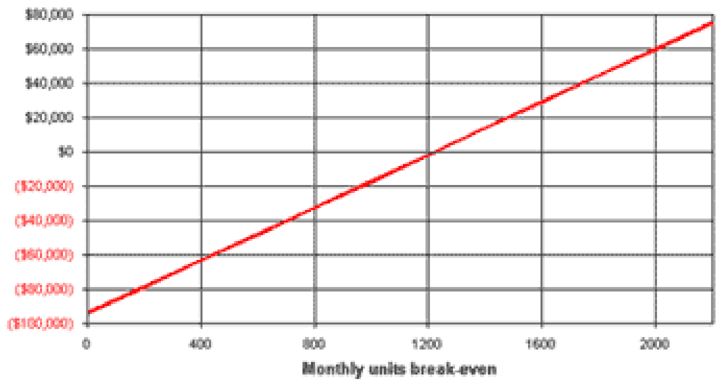
The Break-even Analysis depends on three key assumptions:

- **Average per-unit sales price (per-unit revenue):**

  This is the price that you receive per unit of sales. Take into account sales discounts and special offers. Get this number from your Sales Forecast. For non-unit based businesses, make the per-unit revenue $1 and enter your costs as a percent of a dollar. The most common questions about this input relate to averaging many different products into a single estimate. The analysis requires a single number, and if you build your Sales Forecast first, then you will have this number. You are not alone in this, the vast majority of businesses sell more than one item, and have to average for their Break-even Analysis.
- **Average per-unit cost:**

  This is the incremental cost, or variable cost, of each unit of sales. If you buy goods for resale, this is what you paid, on average, for the goods you sell. If you sell a service, this is what it costs you, per dollar of revenue or unit of service delivered, to deliver that service. If you are using a Units-Based Sales Forecast table (for manufacturing and mixed business types), you can project unit costs from the Sales Forecast table. If you are using the basic Sales Forecast table for retail, service and distribution businesses, use a percentage estimate, e.g., a retail store running a 50% margin would have a per-unit cost of .5, and per-unit revenue of 1.
- **Monthly fixed costs:**
- Technically, a break-even analysis defines fixed costs as costs that would continue even if you went broke. Instead, we recommend that you use your regular running fixed costs, including payroll and normal expenses (total monthly Operating Expenses). This will give you a better insight on financial realities. If averaging and estimating is difficult, use your Profit and Loss table to calculate a working fixed cost estimate—it will be a rough estimate, but it will provide a useful input for a conservative Break-even Analysis.

Break-even chart



The necessary sales volumes to reach break-even for an organisation are calculated using total cost of production.

How to calculate breakeven point is a key financial analysis tool used by business owners. Once you know the fixed and variable costs for the product your business produces, or a good approximation of them, you can use that information to calculate your company's breakeven point. The breakeven point is a popular tool used by small business owners to determine how much volume of their product they must sell in order to make a profit. It's an important part of cost-volume-profit analysis.

In order to calculate your company's breakeven point, use the following formula:

Fixed Costs/Price - Variable Costs

In this formula, fixed costs are stated as a total -- the total fixed costs for the firm. Basically, this means the total overhead for the firm. Price and variable costs, however, are stated as per unit costs - the price for each product sold and the variable cost for that unit of the product. The denominator of the equation, price minus variable costs, is called the **contribution margin.** In other words, this is the amount, per unit of product sold, that the firm can contribute to paying its fixed costs.

Break-even analysis is used to make investment, pricing and purchasing decisions

WHY PRICING DECISION

- For introducing new product in market
- Review of existing price for stimulating market demand/market share or earning higher profit
- For quotations against customers' enquiry

PRICING DECISION

- use of costing methods (job costing or process costing) for ascertaining cost incurred
- pricing based on analysis of cost behaviour into variable cost & fixed cost

SESSION 4. Calculate a selling price by using the mark-up or the margin.
Learning Outcomes
• The concept of break-even for a small business is explained with examples • The selling prices of a product are calculated using Mark-up and profit and a recommendation is made as to the advantages and disadvantages of each method of calculation for the product in question

Calculate a selling price by using the mark-up or the margin.

Price determination for many consumer products is often a function of the cost of production and a desired level of mark-up. Price determination by this desired level of mark-up is often referred to as cost-plus pricing, mark-up pricing or full-cost pricing
There are several "rules-of-thumb" related to mark-up pricing. For example, some retailers who sell to consumers may expect to price items at 20 to 100% above their cost. There is, however, a fine line between the desired mark-up, cost of productionand the price that the market will bear. All of these elements must be carefully understood and respected.
For instance, the price the market will bear is actually a function of demand. For example, a 20%mark-up may yield a selling price that is less than what the market will support. Luxury goods and nicheproducts often command a premium which exceed the set mark-up. That is why cost of production,desired mark-up and market demand should all be evaluated when establishing a product's selling price.

To determine a product's selling price using the mark-up method, the total cost of producing a product ona per unit basis must me known. Total cost should include all of the costs incurred in getting the productto the point of sale. This would include but is not limited to input costs, labour, overhead costs,transportation costs, warehousing costs, distribution costs and marketing costs.

The formula for determining a product's selling price using a desired mark-up percent is:

Selling Price = Total Cost x (1 + Mark-Up Percent)

Selling Price = \$2.00 x (1 + 0.27)

Selling Price = \$2.00 x (1.27)

Selling Price = \$2.54

Therefore, if you want a mark-up of 27% (a profit equal to 27% of total cost) the selling price must be set at \$2.54. Mark-up percent is the proportion of total cost represented by profit.

The concept of break-even for a small business is explained with examples

Break-even analysis is used in cost accounting and capital budgeting to evaluate projects or product lines in terms of their volume and profitability relationship. At its simplest, the tool is used as its name suggests: to determine the volume at which a company's costs will exactly equal its revenues, therefore resulting in net income of zero, or the "break-even" point. Perhaps more useful than this simple determination, however, is the understanding gained through such analysis of the variable and fixed nature of certain costs. Break-even analysis forces the **small business** owner to research, **quantify**, and categorize the company's costs into fixed and variable groups. **Break-even analysis has numerous potential applications for small businesses. For example, it can help managers assess the effect of changing prices, sales volume, and costs on profits.** It can also help small business owners make decisions regarding whether to expand their operations or hire new employees. Break-even analysis would also be useful in the following situation: a small business owner is skeptical of her marketing manager's projection for sales of 15,000 units of a new product, and wants to know what minimum quantity of units must be sold to avoid losing money, assuming a selling price of \$25, fixed costs of \$100,000, and variable costs of \$15. The equation tells her that these parameters will require a break-even volume of 10,000 units; less than that level yields losses, more than that level yields profits. This perspective of analysis may be employed where the analyst is highly confident of the estimates for price and costs, but feels less certain about the assessment of market demand. In this case, the small business owner might be interested in how low sales could fall below the marketing manager's forecast without causing an embarrassment at year-end reporting time.

The selling prices of a product are calculated using Mark-up and profit and a recommendation is made as to the advantages and disadvantages of each method of calculation for the product in question

One of the most important aspects of a business is determining how much money you should sell your product for. If you try to sell it for too much, you risk alienating potential buyers from trying your product. Meanwhile, if you sell it for too little, you risk taking a loss and actually losing money because the cost of creating the product is too great.

- **Figure out the cost of the product.** To do this, determine every factor that goes into producing a single unit. For example, if you are selling books and it costs $5 to produce the material, $3 to put the book together, and another $2 for various expenses (rent, labour), the book costs a total of $10 to produce.
- **Set your break-even price**. Since the book costs $10 to produce, if you sell a book for $10, you will break even. However, since you want to operate your business at profit, you will need to raise the price above that.
- **Determine your profit margin.** This is how much profit you want per item you sell. While in most cases the market will dictate where you set your profit margin (for example, if you set it too high, no one will buy it) a common profit margin is about 20%.
- **Calculate your selling price**. To do so, multiply your profit margin by the break-even price and then add it to the break-even price. In our example, that means multiplying .20 by $10 to get $2, and then adding $2 to our break-even price of $10 to get $12. As such, to achieve a profit margin of 20% for books that cost $10 to produce, you will need to sell the books for $12 apiece.

Important terms

Terms relating to selling prices are:

• Purchase price: this is the cost price – the price you pay to buy the product

• Mark-up: this is the amount you add to the purchase price to get the selling price

• selling price: this is the retail price – the amount you sell the goods for.

Calculating the selling price

The formula for calculating a selling price is:

Selling price = purchase price + mark-up

Mark-up is normally expressed as a percentage of the buying price.

Cost-based pricing: price is determined by adding a profit element on top of the cost of making the product.

Customer-based pricing: where prices are determined by what a firm believes customers will be prepared to pay

Competitor-based pricing: where competitor prices are the main influence on the price set.

Let's take a brief look at each of these approaches;

Cost based pricing

This involves setting a price by adding a **fixed amount or percentage to the cost** of making or buying the product. In some ways this is quite an old-fashioned and somewhat discredited pricing strategy, although it is still widely used.

After all, **customers are not too bothered what it cost to make the product** – they are interested in what **value** the product provides them.

Cost-plus (or "mark-up") pricing is widely used in retailing, where the retailer wants to know with some certainty what the gross profit margin of each sale will be. An advantage of this approach is that the business will know that its costs are being covered. The main disadvantage is that cost-plus pricing may lead to products that are priced un-competitively.

SESSION 5. Apply the concepts of chargeable hours and total hours worked.
Learning Outcomes
• The concepts of "chargeable hours" and "total hours worked" are explained using examples from an organization • The cost and resultant price of a product are calculated using Chargeable hours • The cost and resultant price of a product are calculated using a costing for total hours worked and an explanation given of why chargeable hours is generally used for this purpose.

Apply the concepts of chargeable hours and total hours worked.

Definition:

Total hours worked by all persons employed in the calendar year

Derived concept

- Annual hours worked per
- employed person
- person in the population

Chargeable hours can differ between different companies. In mine, it's basically anything that contributes to generation of income e.g. working on a project for a client, phone calls, emails, faxes, meetings, travel.

Chargeable time is any time that your employer can charge out to your customers/clients for using your services.

Typically at your company there is an hourly 'buy' price associated with you as a resource which equals whatever it costs them to pay you plus their overheads. They will then sell your services on to customers at a higher rate to make money.

Being chargeable means that you are making your company money and not costing them money by just sitting around.

It's quite typical for service based companies that don't actually sell physical products. Don't worry too much about it though. If the company is any good they will play some part in finding you the chargeable work!

A chargeable hour is time you are able to bill the client.

Depending on what the company class as chargeable hours it might include travel. So if you were to leave the office drive 2hrs then do 3 hours work at clients and drive back to the office again being 2hrs that would be 7 chargeable hours? If travel not included then it's 3 hrs that are chargeable.

Hours actually worked per employed are a mathematical concept, derived by dividing the number of all hours worked in a year by the annual average of employed persons. Thus is obtained the average annual hours actually worked per employed. Hours actually worked can also be calculated separately for employees.

The cost and resultant price of a product are calculated using Chargeable hours

Here we will go step-by-step through the calculation for the costs

Step 1: calculate your hourly overhead costs

Start with identifying your annual business overheads by checking your recent monthly or quarterly invoices, identify the various overhead costs, and list them all in a spread sheet or on a piece of paper.

Overhead costs are costs that need to be paid regardless of sales, so for example include your studio rent, phone and mobile, insurance, utilities, marketing, storage, business rates. These are the invoices that you pay often on a regular basis. Don't include your drawings/salary or raw materials.

For our example we use £12K p.a. (PS your figure will not be as perfectly round as this!)

Let's assume the milliner has 4 weeks holiday, this makes £12K/48 weeks = £250 per week.

Now work out how many hours per week she actually spends on average making hats, so don't include marketing, admin, meetings and the like. In your first years you do well if you spend 40 – 50% of your time physically making.

So let's say 40 hours per week working x 40% = 16 hours per week physically making.

The hourly overhead costs will then be £250/16h = £15.62

To keep her millinery studio running with these overheads she needs to generate at least £250 every week plus a salary to cover personal living expenses. Even if she doesn't sell anything she will need to cover both these costs. Therefore it is really important to keep your overheads as low as possible, especially when you are just starting out. See if you can share a studio or work from home to minimise your costs and to get your crafts business off the ground.

Step 2: calculate your hourly wage

Let's say the milliner wants to earn gross £22K p.a. (to cover her personal budget, rent, food, clothes, national insurance and tax etc.).

How much salary you need or want depends on many personal circumstances, such as where you live and with whom you live, and what you want or need to have the lifestyle you want.

We use the same figures as previously: 48 weeks x 40h x 40% = 768 hours, so that makes an hourly wage requirement of £22K/768 = £28.65

Step 3: calculate your total hourly rate

This is your hourly overhead costs + hourly wage = £ 15.62 + £28.65 = £ 44.27

Step4: Calculate how long it will take you to produce one product

How long does it take you to produce one product? You hopefully have made your production a bit more efficient and effective and combine various jobs together and produce products in small batches.

If you don't know the answer to this question, don't guess! Check out with a time sheet and keep a time log. You might be surprised how different your guess is from the reality

Remember to include all production processes, including cutting fabrics, sewing, finishing and packaging. Use averages e.g. you cut 6 hats in 2 hours, resulting in 20 min per hat on average.

Let's say total time spend to get 1 hat ready is 2.25 hours x hourly rate = £99.60

(It is always good to calculate backwards too: if you are actually making 16 hours per week, does this calculation mean that you indeed produce 7 hats per week? – is this enough, too many or too little? Use this calculation to improve your own management.)

Step 5: Calculate the total material costs

Add all the costs of the materials to produce one hat. Don't skimp, it really is important to have a bit of contingency, and don't use the cheapest materials. We will use £22 in our example.

Tip: Don't use the cheapest materials: if you use a very cheap zip for example your overall product will look cheap, but the chances are that it will break sooner too, and the cost of replacing a broken zip are far higher than using a good zip in the first place.

Step 6: Add contingency

Contingency is 'just in case' and we suggest a contingency percentage of around 10%. If your product is very expensive you might go for a lower percentage, or if you have a lot of experience with similar products you can lower this figure too.

Contingency will allow for mistakes, hidden extra etc. and will allow you to offer discounts or special offers.

Step 7: Calculate your total cost price

Add £ 99.60 + £22 x 110% = £133.76

This is the amount that it cost to produce one hat. That's it! You have done it!

So what do you think about that cost figure? Is it too expensive? The answer often depends where you want to position yourself in the market. Also, from calculating the cost you can start pricing your product, and there are lots of different ways to price your product.

The cost and resultant price of a product are calculated using a costing for total hours worked and an explanation given of why chargeable hours is generally used for this purpose.

Module 4

LEARNER GUIDE

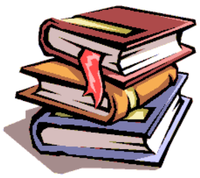
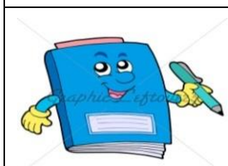
Perform Financial Planning and Control Functions for a Small Business

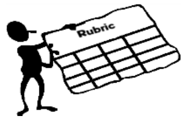
Learner Information:

Details	Please Complete this Section
Name & Surname:	
Organisation:	
Unit/Dept:	
Facilitator Name:	
Date Started:	
Date of Completion:	

Key to Icons

The following icons may be used in this Learner Guide to indicate specific functions:

 **Books**	**This icon means that other books are available for further information on a particular topic/subject.**
 **References**	**This icon refers to any examples, handouts, checklists, etc…**
 **Important**	**This icon represents important information related to a specific topic or section of the guide.**
 **Activities**	**This icon helps you to be prepared for the learning to follow or assist you to demonstrate understanding of module content. Shows transference of knowledge and skill.**
 **Exercises**	**This icon represents any exercise to be completed on a specific topic at home by you or in a group.**

 Tasks/Projects	An important aspect of the assessment process is proof of competence. This can be achieved by observation or a portfolio of evidence should be submitted in this regard.
 Workplace Activities	An important aspect of learning is through workplace experience. Activities with this icon can only be completed once a learner is in the workplace
 Tips	This icon indicates practical tips you can adopt in the future.
 Notes	This icon represents important notes you must remember as part of the learning process.

Learner Guide Introduction

About the Learner Guide…	This Learner Guide provides a comprehensive overview of the **Perform Financial Planning and Control Functions for a Small Business**, and forms part of a series of Learner Guides that have been developed for **NATIONAL CERTIFICATE: SMALL BUSINESS FINANCIAL MANAGEMENT at NQF Level 5, worth 145credits.** The series of Learner Guides are conceptualized in modular's format and developed**NATIONAL CERTIFICATE: SMALL BUSINESS FINANCIAL MANAGEMENT Learning Programme.** They are designed to improve the skills and knowledge of learners, and thus enabling them to effectively and efficiently complete specific tasks. Learners are required to attend training workshops as a group or as specified by their organization. These workshops are presented in modules, and conducted by a qualified facilitator.
Purpose	The purpose of this Learner Guide is to provide learners with the necessary knowledge related to **Perform Financial Planning and Control Functions for a Small Business.**
Assessment Criteria	The only way to establish whether a learner is competent and has accomplished the specific outcomes is through an assessment process. Assessment involves collecting and interpreting evidence about the learner's ability to perform a task.

	This guide may include assessments in the form of activities, assignments, tasks or projects, as well as workplace practical tasks. Learners are required to perform tasks on the job to collect enough and appropriate evidence for their portfolio of evidence, proof signed by their supervisor that the tasks were performed successfully.
To qualify	To qualify and receive credits towards the learning program, a registered assessor will conduct an evaluation and assessment of the learner's portfolio of evidence and competency
Range of Learning	This describes the situation and circumstance in which competence must be demonstrated and the parameters in which learners operate
Responsibility	The responsibility of learning rest with the learner, so: • Be proactive and ask questions, • Seek assistance and help from your facilitators, if required.

Learning Unit 1 Perform Financial Planning and Control Functions forSmall Business

UNIT STANDARD NUMBER	:	114738
LEVEL ON THE NQF	:	4
CREDITS	:	6
FIELD	:	Business, Commerce and Management Studies
SUB FIELD	:	Finance, Economics and Accounting

PURPOSE:	This Unit Standard is for people who are responsible for controlling the finances of a small business or who are responsible for the bookkeeping aspect of financial management in larger organisations. Qualifying learners will be able to: Prepare a business plan. Monitor actual performance against a budget. Make decisions on purchasing of fixed assets. Understand the importance of financial reporting.

LEARNING ASSUMED TO BE IN PLACE:
It is assumed that learners are competent in Communication, Mathematical Literacy and Accounting at NQF Level 3.

SESSION 1. Prepare a business plan suitable for submission to a financial institution.
Learning Outcomes
• The various components that should be included in a business plan that will be submitted to a financial institution are identified with examples given from the plan of a successful organisation. • A business plan is constructed in a form that would be generally acceptable by a financial institution.

Prepare a business plan suitable for submission to a financial institution.

Business planning helps determine if a successful outcome will be achieved. Business plans include business marketing, financial and management details.

Sections to Include in Business Plans

A new business plan will generally have sections to cover different areas of the business. These generally include:

- **Executive Summary** – An overview of the business plan to highlight key areas.
- **Company/Business Description** – Describes the business, including legal establishment, history, purpose of the business and direction for the business.
- **Products / Services** – Describes what the business will be selling or what services it will be providing.
- **Market and Industry Analysis** – Provides analysis of current market and industry trends to establish the viability of a new business and projects the market share which the business may acquire.
- **Business Marketing Strategy and Implementation** – Identifies the markets and methods to execute the marketing strategies. Includes projected sales budgets.
- **Operations and Management** – Identifies how staff will be utilized, what systems will be in place, software which will be used and products or service development. Describes the management team and their responsibilities.

- **Financial Analysis** – Includes any past available financial reports, projected profit and loss statements, cash flow tables and budgets.

It is also advisable to include a section for contingency plans. This section should identify potential risks to projected sales and marketing. Include strategies which may be implemented if these potential risks where to occur.

Business Planning - Where to Start

Preparing a business plan need not be developed in the above order, but started with **Market and Industry Analysis**. By identifying current market trends, customers' needs, how to approach them, along with a general industry analysis may help determine how and when to start a new business. There needs to be a demand for a product or service before any profit can be made. This process helps to highlight opportunities, or lack of, that might otherwise not be obvious. Business marketing is a vital section to include in the plan.

Business plans need to be simple, specific, realistic and complete. A good plan will also require someone to follow up and check on it, to ensure all areas are being implemented. Developing a business plan helps to highlight the areas of strength and areas which will require the most attention. A business plan also helps determine if a new business is going to have a successful and profitable longer term outcome.

A great business plan requires.

- significant research and strategic thinking about the direction of the business
- the entrepreneur to challenge deeply-held beliefs about the product/opportunity/market
- time commitment away from running the business
- a level of detail and process that are painful for the typical entrepreneur
- Strategy is all about making choices…generally tough ones.
- The best strategies emerge from making the best choices
- Exposes your idea/thinking to critique

Parts of the Business Plan

The Executive Summary. To summarize the presentation to each potential financial institution or investor, the entrepreneur should develop an executive summary. It should he concise—a maximum of two pages—and should summarize all of the relevant points of the proposed deal. The summary should explain the purpose of the financial request, the dollar amount requested, how the funds will be used, and how any loans will be repaid. It is designed to capture the reader's attention. If it misses, the chances of the remainder of the plan being read are minimal. A well-developed, coherent summary introducing the financial proposal will establish a favourable first impression of the owners and the business, and can go a long way toward obtaining financing. Although the executive summary is the first part of the business plan, it should be the last section written.

Company History. The manager of an existing small business should prepare a brief history of tile operation, highlighting the significant financial and operational events in the company's life. This section should focus on the successful accomplishment of past objectives and should indicate the firm's image.

Business Profile. To familiarize lenders and investors with the nature of the business, the owner should incorporate into the business plan a general description of its operation. This section should begin with a statement of the company's general business goals and a narrower definition of its immediate objectives. Together, they define what the business plans to accomplish, how, when, and who will do it. Goals are long-range, broad statements of what the company plans to accomplish in the distant future. They are aspirations that guide the overall direction of the company and express the company's raison d'être. In other words, they answer the question, "Why am I in business?" Answering such a basic question appears to be obvious, but many entrepreneurs cannot define the basic purpose of their businesses. The director of an entrepreneurial boot camp says, it's amazing what a tortuous experience [defining the business' purpose] can be. It's hard for them to distil their ideas . . . Many people don't know what business they are in."

The owner of a small chain of baby products stores has clearly defined his company's mission.

To serve best the needs of customers who are retail stores offering an incomparable combination of selection, quality, and service at competitive prices?

Objectives, on the other hand, are short-term, specific targets that are attainable, measurable, and controllable. Every objective should reflect some general business goal and include a technique for measuring progress toward its accomplishment. To be meaningful, an objective must have a time frame for achievement.

In summarizing the small company's background, the owner should describe the present state of the art in the industry and identify the key factors needed for success in the market segment she will compete in. She should describe the current applications of the product/service in the market and include projections for future applications. For example, a manufacturer of silicon chips could discuss the key role his product plays in computer technology and could project increased demand by robot manufacturers. In addition, the owner should incorporate into the plan general long-term growth trends for the entire industry, including stability for product demand and emerging trends affecting demand. This section also should describe the influence of government regulation and legislation in the business operation.

Business Strategy. An even more important part of the business plan is the owner's view of the strategy needed to meet the competition. It should comment on how the owner plans to achieve business objectives in the face of competition and government regulation. One investment adviser states, "Many business plans give fancy, impressive financial projections, but don't sufficiently tell you how the company is going to reach these projections." The manager also must describe the firm's desired character—the image the business will try to project.

For example, a clothing store could project several images: a high quality, classic merchandise shop; a trendy, high fashion store; or an economy-oriented discount outlet. This segment of the business plan should outline the methods the company can use to meet the key requirements for success identified earlier. If, for example, a strong, well-trained sales force is considered a critical element for success, the owner must develop a plan of action for assembling one. This section should highlight basic strategic elements.

Description of Firm's Product/Service. The business owner should describe the company's overall product line, giving an overview of how the goods/ services are used. Drawings, diagrams, and illustrations may be required if the product is highly technical. It is best to write product and service descriptions so that laypeople can understand them. A statement of the goods' position in the product life cycle might also he helpful. The manager should include a summary of any patents, trademarks, or copyrights protecting the product or service from infringement by competitors. Finally, the owner should provide an honest comparison of the company's product or service with those of competitors, citing specific advantages or improvements that make her goods or services unique and indicating plans for developing next generation goods and services that evolve from the present product line.

Manufacturers should provide a description of the production process employed, strategic raw materials required, and sources of supply used. In addition, they should summarize the method of production and illustrate the plant layout.

Marketing Strategy. One of the most crucial Concerns of potential lenders and investors is whether there is a real market for the proposed good or service. Every small business owner seeking funds must incorporate into the business plan a description of the company's target market and its characteristics. Defining the target market and its potential is one of the most important and most difficult parts of a business plan. It must show how the entrepreneur plans to turn the idea into a product or service customers will want to buy. For example, the owner of a small chain of baby products stores identified his firm's typical customer as an expectant mother 18 to 34 years old (an average of 26.3 years) in the fifth to eighth month of pregnancy, most often shopping with her mother. One venture capitalist claims that the investor "needs to believe that the company has targeted an attractive market and has developed a plan to capture an unfair share of it."

The various components that should be included in a business plan that will be submitted to a financial institution

Components of a Business Plan:

What are the parts of a business plan? A good business plan has ten key parts. Covering each of these areas is important if you want to attract investors. Learn about the first five of these components of a good business plan here.

1. Executive Summary. The Executive Summary provides a succinct synopsis of the business plan, and highlights the key points raised within. The Executive Summary must communicate to the prospective investor the size and scope of the market opportunity, the venture's business and profitability model, and how the resources/skills/strategic positioning of the Company's management team make it uniquely qualified to execute the plan. The Executive Summary must be compelling, easy-to-read, and no longer than 2-4 pages.

2. Company Analysis. This section provides a strategic overview of the company and describes how the company is organized, what products and services it offers/will offer, and goes into further detail on the company's unique qualifications in serving its target markets.

3. Industry Analysis. This section evaluates the playing field in which the company will be competing, and includes well-structured answers to key market research questions such as the following:

What are the sizes of the target market segments?

What are the trends for the industry as a whole?

With what other industries do your services compete?

4. Analysis of Customers. The Customer Analysis section assesses the customer segment(s) that the company serves. In this section, the company must convey the needs of its target customers. It must then show how its products and services satisfy these needs to an extent that the customer will pay for them

5. Analysis of Competition. This section defines the competitive landscape of your business. It identifies who the direct and indirect competitors are, assesses their strengths and weaknesses and delineates your company's competitive advantages.

The first five sections of a business plan are critical because in most cases, investors will not read the full plan. As such, winning the investor's interest early is critical. In addition to providing background on the full business opportunity, these sections provide the market research to back up the business' potential, another critical factor in gaining an investment.

6. Marketing Plan. The marketing plan details your strategy for penetrating the target markets. Key components include the following:

- A description of the company's desired strategic positioning
- Detailed descriptions of the company's product and service offerings and potential product extensions
- Descriptions of the company's desired image and branding strategy
- Descriptions of the company's promotional strategies
- An overview of the company's pricing strategies
- A description of current and potential strategic marketing partnerships/ alliances

7. Operations/Design and Development Plans. These sections detail the internal strategies for building the venture from concept to reality, and include answers to the following questions:

- What functions will be required to run the business?
- What milestones must be reached before the venture can be launched?
- How will quality be controlled?

8. Management Team. The Management Team section demonstrates that the company has the required human resources to be successful. The business plan must answer questions including:

- Who are the key management personnel and what are their backgrounds? What management additions will be required to make the business a success?
- Who are the other investors and/or shareholders, if any?
- Who comprises the Board of Directors and/or Board of Advisors?
- Who are the professional advisors (e.g., lawyer, accounting firm)?

9. Financial Plan. The Financial Plan involves the development of the company's revenue and profitability model. It includes detailed explanations of the key assumptions used in building the model, sensitivity analysis on key revenue and cost variables, and description of comparable valuations for existing companies with similar business models.

In addition, the financial plan assesses the amount of capital the firm needs, the proposed use of these funds, and the expected future earnings. It includes Projected Income Statements, Balance Sheets and Cash Flow Statements, broken out quarterly for the first two years, and annually for years 1-5. Importantly, all of the assumptions and projections in the financial plan must flow from and be supported by the descriptions and explanations offered in the other sections of the plan. The Financial Plan is where the entrepreneur communicates how he/she plans to "monetize" the overall vision for the new venture.

10. Appendix. The Appendix is used to support the rest of the business plan. Every business plan should have a full set of financial projections in the Appendix, with the summary of these financials in the Executive Summary and the Financial Plan. Other documentation that could appear in the Appendix includes technical drawings, partnership and/or customer letters, expanded competitor reviews and/or customer lists.

Expertly and comprehensively discussing these components in their business plan helps entrepreneurs to better understand their business opportunity and assists them in convincing investors that the opportunity may be right for them too.

A business plan is constructed in a form that would be generally acceptable by a financial institution.

When constructing a business plan, consider the audience who will be reading the document. Most times, business plans are constructed to help "sell" the organization to others, especially when looking for funding. However for most organizations the most important audience is their own membership and board. By taking the time to think through the basics, the day-to-day operations of an organization will become easier.

Key elements

Your business plan is nothing without a business plan executive summary - here's what to add:

- Your business vision
- Your target customers
- Your core products
- Why you are better than your competitors
- An overall financial summary
- A profile of key players
- The purpose of the plan (i.e.: to gain finance)

The most important part of a business plan

Your business plan executive summary really is the most important element of your business plan so pay special attention to the detail that is contained on this page.

You'll find that everyone you present your plan to will read this page and then look at your finances. If they require more detail they will look within your plan for the answers.

Spend time wisely

It's best to sketch out a rough business plan executive summary before you start your planning. This will act as a rough vision of what you want to achieve.

Then create your business plan in the normal manner in detail. You can then complete your executive summary at the end after you have completed the rest of your plan and your financial statements.

SESSION 2.

Monitor actual performance of an organisation against budget.

Learning Outcomes

- A columnar budget is constructed so that planned income and expenditure can be compared against actual income and expenditure.
- Positive and negative variances are identified using standard financial management practice.
- A report is drawn up on the financial position of the organization resulting from the comparison of actual versus budgeted income and expenditure so as to aid decision-making and future action for the organisation.

Monitor actual performance of an organisation against budget.

Listed below are the main generic 'skills' that need to be applied in managing a budget. These skills are explicit/implicit in the detailed content of the unit and are listed here as additional information.

- Communicating
- Decision-making
- Monitoring
- Acting assertively
- Presenting information
- Reporting
- Learning
- Negotiating
- Consulting
- Information management
- Evaluating
- Contingency-planning

- Problem-solving

Behaviours which underpin effective performance

1. You present information clearly, concisely, accurately and in ways that promote understanding.
2. You act within the limits of your authority.
3. You show integrity, fairness and consistency in decision-making.
4. You say no to unreasonable requests.
5. You use communication styles that are appropriate to different people and situations.
6. You take and implement difficult and/or unpopular decisions, if necessary.
7. You respond quickly to crises and problems with a proposed course of action.

You need to know and understand the following:

1. The purposes of budgetary systems.
2. Where to get and how to evaluate the available information in order to be able to prepare a realistic budget.
3. The importance of spending time on and consulting with others in preparing a budget.
4. How to discuss, negotiate and confirm a budget with people who control the finance and the key factors that should be covered.
5. How to use a budget to actively monitor and control performance for a defined area or activity of work.
6. The main causes of variances and how to identify them.

A columnar budget is constructed so that planned income and expenditure can be compared against actual income and expenditure.

A budget also serves a lot of other purposes:

- It is a simple way to make financial information accessible to all people in the organisation who need to use it. Each member or staff member should know how much money is available for what part of your work.
- It helps you to understand exactly what your work will cost and what limitations you have so that your plans can be made more realistic.
- It clarifies where you have gaps and need to do more fund-raising. It also helps to write fund-raising proposals based on realistic costing.

- All financial statements should be written in terms of the budget so that it is easier to be transparent and accountable and to ensure that no money is spent on costs that you have not budgeted for.
- It helps members or executive members or management to monitor expenditure throughout the year and to make sure that it is in line with the budget amounts - monitoring should happen every month or two and should be in terms of the budget categories.
- It makes reporting to members or funders much easier since the expenditure can be compared to the amounts that you actually budgeted.
- A good budget can also help to avoid waste. When every amount is carefully calculated, it is easy to see how your money is being spent and to decide whether you are making any unnecessary expenditure.

Important things to know about budgets

A budget should be drawn up on the basis of three main factors:

- A budget should always be based on proper plans, drawn up to make sure that you reach your goals for that year. A budget should be the summary of all the costs and income that you will receive that will make sure that your plans are implemented.
- The costs in the budget should be based on your financial statements of the previous year and the budget items should compare the expenditure of the previous year to this year. This will show that your budget is based on fact and experience.
- The budget should be realistic and should also show what income you expect and what income you would still need to raise.

Every budget should contain a number of categories.The two main categories are "Expected Expenditure" and "Expected Income".

Under the Expected Expenditure the categories could be:

- **Capital costs** - things that you have to buy like computers, cars etc.
- **Running costs** - expenditure that will help your organisation to run an office and administration to do its work: items like rent, electricity, telephone, hiring of equipment.

- **Staff costs** - salaries, staff benefits, staff training etc.
- **Project costs or operational costs** - costs that are linked to the specific projects or campaigns that you plan to run that year. This would include things like buying materials, printing costs, transport costs, workshop costs, catering, media production, venues, sound systems etc.

Under the Expected Income of the organisation you should include categories like:

- **Donor funds** - list each funder and the amount you expect from them,
- **Membership fees** - if your members pay fees list the amount you expect to get this year,
- **Donations** - list the amount you expect to get from small public donations,
- **Fund-raising events** - if you plan to organise events, list what profit you expect to make and
- **Sales** - if you sell your services or any products.

The budget should clearly show whether there is a difference between your Expected Expenditure and your Expected Income. If you will get more money than you will spend, this is called an expected surplus; if you will get less money it is called a deficit. When your budget shows a deficit you will obviously need to either cut the budget or do some serious fund-raising to make up the amount.

It is very important to write a budget in such a way that all amounts are justified and explained. For example if you want to spend R100 000 on salaries, you should explain how many people will be employed for how much money.

Positive and negative variances are identified using standard financial management practice.

Variance analysis is the practice of reviewing the difference or variance between actual financial performance and budget/forecast figures.

The comparison for each budget/forecast account compares the current period to the corresponding period last year or last quarter and makes it easier to forecast the overall year-end result.

Reviewing variances allows business management to understand the causes of variances and then to control future costs. At the same time, variance analysis checks the validity of the budget or forecast and helps refine future budgets and forecasts.

Variance analysis can also act as an early warning system to highlight any trends in financial performance **(positive or negative)** as they emerge.

A variance is the difference between the projected budget and the actual performance for a particular account. A negative variance means that the budgeted amount was greater than the actual amount spent. A positive variance means that the budgeted amount was less than the actual amount spent.

A report is drawn up on the financial position of the organization resulting from the comparison of actual versus budgeted income and expenditure so as to aid decision-making and future action for the organisation.

Financial statements are usually created at the end of an annual accounting period. These statements provide important information to external users because the financial information is based on a longer period of time and must follow specific reporting guidelines. However, a monthly financial statement can inform internal users regarding recent financial activity. These statements can be timely in identifying trends and addressing problems without having to wait months for the year-end financial statements.

The financial situation of an organization is shown to its members through various types of statements. They include:

- Budget
- Income Statement
- Project or Event Report
- Balance Sheet

All financial statements indicate the type of statement, the organization's name, and the date or time period it covers.

Members learn about the financial health of their organization by reading the financial statements. It is your responsibility as a director or member to understand the financial statements of your organization. You will then be able to determine the financial status of your organization and make sound financial decisions to ensure that it remains healthy.

The balance sheet is a snapshot of the company's financial standing at an instant in time. The balance sheet shows the company's financial position, what it owns (assets) and what it owes (liabilities and net worth). The "bottom line" of a balance sheet must always balance (i.e., assets = liabilities + net worth). The individual elements of a balance sheet change from day to day, and reflect the activities of the company. Analyzing how the balance sheet changes over time will reveal important information about the company's business trends.

Types of financial statements and reports

Basically there are four financial statements. These are balance sheet, income statement, statement of retained earnings and statement of cash flows.

Balance sheet: It is the statement regarding financial position of a business, which includes reports on a company's assets, liabilities and net equity on any date or for any accounting period.

Income statement: It is also termed as profit and loss statement or statement of revenue and expense. It is a financial statement that evaluates a company's financial performance over an accounting period of time. This statement depicts the summary of the revenues and expenses of a business. This statement also depicts net profit or loss incurred by the organization over an accounting period of time.

Statement of retained earnings: This statement explains about the retained earnings of an organization. Retained earnings are the percentage of net earnings that are not paid out as dividends. It is retained by the company with an intention to reinvest in core business.

Statement of cash flows: This statement measures the financial health of the organization. Cash flow is equal to the cash receipts minus cash payments over a specific period of time. This statement basically depicts information regarding the operating, investing and financing activities of an organization.

SESSION 3. Decide on the purchase of fixed assets based on highest financial return.
Learning Outcomes
• Investment appraisal techniques are used to calculate forecast returns from the potential purchase of fixed assets. • The results of investment appraisal calculations are used to decide which fixed assets to purchase.

Investment appraisal techniques are used to calculate forecast returns from the potential purchase of fixed assets.

Investment Appraisal
Purpose

All businesses require capital equipment (fixed assets) such as machinery, premises and vehicles. **The purchase of such assets is known as capital investment and is undertaken for the following reasons:**

1. To replace existing equipment which is out-of-date or obsolete
2. To expand the productive capacity of the business
3. To reduce the production costs per unit (i.e. to achieve economies of scale)
4. To produce new products and, therefore, break into new markets

Capital investment, like all other business activities, involves an element of uncertainty, because expenditure is incurred today in order to produce some benefit in the future. Investment appraisal techniques are designed to aid decision-making regarding such investment projects.

There are 3 methods which can be used to appraise any investment project:

1. The Payback method
2. The Average Rate of Return (A.R.R) method
3. The Net Present Value (N.P.V) method.

Advantages & Disadvantages of ARR

Advantages

- It clearly shows the profitability of a project
- It allows easy comparison between projects
- The opportunity cost of investment can be taken into account

Disadvantages

- More complex than payback
- It does not take into account the effects of inflation on the
- value of money over a time per

Advantages of Payback

- It is extremely simple
- It is useful where technology changes rapidly (cost of machinery
- is recovered before new model comes out.)
- Helps prevent cashflow problems - since one will be recovered as quickly as possible

Disadvantages of P Payback

Cash earned after the payback method is ignored.

It does not account for the real value of money.

There are many other factors that a business will need to take into consideration when appraising an investment project, other than the financial (quantitative) factors.

- **Qualitative factors** such as the objectives of the business must be considered at all times, as well as the effect upon the employees of new machinery, new working practices and changes to their working conditions.
- The external environment needs to be considered before any decision can be taken regarding a proposed investment project.
- These factors include the state of the economy (e.g. it may be dangerous to attempt to expand during a recession, because demand for products may be falling), pressure group activity, the level of technological progress in the industry (e.g. competitors may already be using the new machinery), and any legislation (e.g. restricting the use of certain materials, components).
- The effects of the actions of the business on the environment must also be taken into consideration, since any external costs (e.g. pollution) will have a detrimental effect on the image and reputation of the business.

- Finally, as with any investment decision, the business will also need to consider the amount of finance that is available for expansion, and the effect that any borrowing to raise extra finance will have on the gearing ratio.

You must remember:

- that long term projects under consideration should be consistent with the long term corporate plan
- that the estimated cash inflows from the project when discounted to a common date, the present, exceed the estimated outflows, also discounted to the present
- that the theory in this section assumes certainty of knowledge and forecasting – this is relaxed in the next chapter
- that, in practice, businesses do not wholeheartedly follow the theoretically correct route of using the net present value approach (NPV) all the time.

The results of investment appraisal calculations are used to decide which fixed assets to purchase.

SESSION 4.

Understand the importance of financial reporting.

Learning Outcomes

- The different types of financial reporting done by a small organization are identified and an indication given of the target audience of each report.
- The advantages of producing periodic financial reports/statements are explained with examples.
- The dangers presented to a small business by the absence of financial reports are explained with the use of examples.

Understand the importance of financial reporting.

Financial statements are important reports. They show how a business is doing and are very useful internally for a company's stockholders and to its board of directors, its managers and some employees, including labor unions. Externally, they are important to prospective investors, to government agencies responsible for taxing and regulating, to lenders such as banks and credit rating agencies, and to investment analysts and stockbrokers

Importance of Regularity and Accuracy

- All public companies are required to prepare documents showing the company's financial performance at regular periodic intervals. Most companies prepare annual statements; others prepare them semi-annually, quarterly or as often as monthly. These show the financial wealth of a company (how much it owes and owns) but can be manipulated. It is often required that statements for external consumption be audited by independent accounting firms.

Parts of Financial Statements

- The three basic parts of financial statements are: a balance sheet, which basically lists all of the assets and liabilities of the business at the end of the period, the difference between the two being the company's net worth; a profit-and-loss statement, which answers the question of how the company did from the beginning to the end of the accounting period; and a cash flow statement, which says where the cash of the business went and where it came from during the accounting period.

Importance of Each Part

- Among other things, analysis of balance sheets can tell whether the company owes too much or is lending too much or has too much in inventory; its detailed attachments detail who is owed and who owes the company and what properties it owns, if any. Analysis of income statements can tell whether prices or volumes sold are not high enough to give sufficient profits and what the big and small costs of the business are. Analysis of cash flows can tell whether most needs are met through internally generated funds or whether some come from borrowings.

Importance to Managers

- Managers of businesses, more than any of the other users, benefit most from the use of financial statements, especially those who are good at understanding and analyzing these statements. Managers are able to not only discover problems and find corrective actions needed through financial statements but they are also able to make projections of these statements that act as goals and standards for upcoming periods. They are then able to assess performances against these projections at the end of the accounting period.

Importance to Others

- Current and potential investors and lenders always require financial statements for their lending or investment decisions. In important board and stockholder meetings, copies of these are always given out to participants. Analysts, brokers, rating agencies and money managers dig into these before making recommendations. Major customers and suppliers of businesses ask for these in order to stay informed. Corporate raiders, competitors and potential competitors attempt to get these before plunging into a business.

The different types of financial reporting done by a small organization are identified and an indication given of the target audience of each report.

There are three types of financial statements. Each will give you important info about how efficiently and effectively your business is operating.

1. Income Statement

The income statement shows all items of income and expense for your arts or crafts business. It reflects a specific time period. So, an income statement for the quarter ending March 31, shows revenue and expenses for January, February and March; if the income statement is for the calendar year ending December 31, it would contain all your information from January 1 to December 31.

Income statements are also known as statements of profit and loss or P&Ls. The bottom line on an income statement is income less expenses. If your income is more than expense, you have a net profit. Expense more than income? You have a net loss.

2. Balance Sheet

Accounting is based upon a double entry system - for every entry into the books there has to be an opposite and equal entry. The net effect of the entries is zero, which results your books being balanced. The proof of this balancing act is shown in the balance sheet when Assets = Liabilities + Equity.

The balance sheet shows the health of a business from day one to the date on the balance sheet. Balance Sheets are always dated on the late day of the reporting period. If you've been in business since 1997 and your balance sheet is dated as of December 31 of the current year, the balance sheet will show the results of your operations from 1997 to December 31.

3. Statement of Cash Flows

The statement of cash flows shows the ins and outs of cash during the reporting period. You may be thinking – well who needs that type of report? I'll just look at the check book. Good point, unless you're reporting things that don't immediately affect cash such as depreciation, accounts receivable and accounts payable.

If I could only choose one of those three financial statements to evaluate the ability of a company to pay dividends and meet obligations (indicating a healthy business) I would pick the statement of cash flows. The statement of cash flows takes aspects of the income statement and balance sheet and kind of crams them together to show cash sources and uses for the period.

The advantages of producing periodic financial reports/statements are explained with examples.

There are three main financial statements investors analyze. They are the balance sheet, income statement and the cash flow statement. The balance sheet is a snapshot in time. It shows all the assets owned and liabilities owed for a company. It also shows the amount of equity or ownership that is paid for by investors. The income statement looks at the entire year. It starts with revenues and then deducts expenses for net income. The cash flow statement shows where the cash is really coming by breaking down cash flow into cash from operations, investing and financing. There are advantages and disadvantages to analyzing financial statements for investment decisions.

Full Disclosure

- Full disclosure is one of the main advantages of, and one of the main purposes for, financial statements. The Securities and Exchange Commission made the 10K report a requirement for all public companies. This 10K includes full disclosure of all financial statements as well as notes explaining all assumptions contained with the notes.

Intrinsic Value vs. Market Value

- While financial statements are good for the data needed to conduct a thorough ratio analysis, they are based on the accrual system of accounting, which is not market based. This is both an advantage and a disadvantage. It's good to have a basis for comparing book value to market value. Above all it helps to pinpoint bargains in the market. However, value discrepancies can also work to the disadvantage of financial statement analysis. It can make it difficult to know the real value of assets, which translates into unreliable ratios.

Transparency

- Unfortunately, since financial statements are easy for everyone to understand, it's also very easy for people to hide information. For instance, an analyst has to look at the cash flow statement to know if cash flow is coming from operations or additional financing activities. There are also certain conventions like depreciation and inventory accounting that can increase or decrease net income, depending on the convention used.

The dangers presented to a small business by the absence of financial reports

Module 5

LEARNER GUIDE

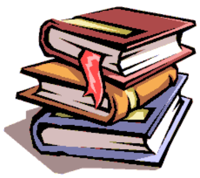
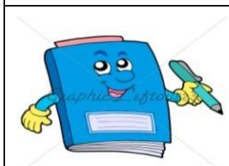
Calculate tax payable by a small business

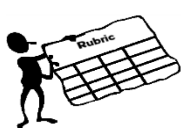
Learner Information:

Details	Please Complete this Section
Name & Surname:	
Organisation:	
Unit/Dept:	
Facilitator Name:	
Date Started:	
Date of Completion:	

Key to Icons

The following icons may be used in this Learner Guide to indicate specific functions:

 **Books**	**This icon means that other books are available for further information on a particular topic/subject.**
 **References**	**This icon refeR to any examples, handouts, checklists, etc…**
 **Important**	**This icon represents important information related to a specific topic or section of the guide.**
 **Activities**	**This icon helps you to be prepared for the learning to follow or assist you to demonstrate undeRtanding of module content. Shows transference of knowledge and skill.**
 **Exercises**	**This icon represents any exercise to be completed on a specific topic at home by you or in a group.**

 **Tasks/Projects**	**An important aspect of the assessment process is proof of competence. This can be achieved by observation or a portfolio of evidence should be submitted in this regard.**
 **Workplace Activities**	**An important aspect of learning is through workplace experience. Activities with this icon can only be completed once a learner is in the workplace**
 **Tips**	**This icon indicates practical tips you can adopt in the future.**
 **Notes**	**This icon represents important notes you must remember as part of the learning process.**

Learner Guide Introduction

About the Learner Guide…	This Learner Guide provides a comprehensive overview of the Perform Financial Planning and Control Functions for a Small Business, and forms part of a series of Learner Guides that have been developed for **National Certificate: Small Business Financial Management at NQF Level 4, worth 120 credits.** The series of Learner Guides are conceptualized in modular's format and developed **National Certificate: Small Business Financial Management Learning Programme.** They are designed to improve the skills and knowledge of learner, and thus enabling them to effectively and efficiently complete specific tasks. Learner are required to attend training workshops as a group or as specified by their organization. These workshops are presented in modules, and conducted by a qualified facilitator.
Purpose	The purpose of this Learner Guide is to provide learner with the necessary knowledge related to **Calculate tax payable by a small business**
Assessment Criteria	The only way to establish whether a learner is competent and has accomplished the specific outcomes is through an assessment process. Assessment involves collecting and interpreting evidence about the learner's ability to perform a task.

	This guide may include assessments in the form of activities, assignments, tasks or projects, as well as workplace practical tasks. Learners are required to perform tasks on the job to collect enough and appropriate evidence for their portfolio of evidence, proof signed by their supervisor that the tasks were performed successfully.
To qualify	To qualify and receive credits towards the learning program, a registered assessor will conduct an evaluation and assessment of the learner's portfolio of evidence and competency
Range of Learning	This describes the situation and circumstance in which competence must be demonstrated and the parameters in which learners operate
Responsibility	The responsibility of learning rest with the learner, so: • Be proactive and ask questions, • Seek assistance and help from your facilitators, if required.

Learning Unit 1 Calculate tax payable by a small business

UNIT STANDARD NUMBER : 114742
LEVEL ON THE NQF : 4
CREDITS : 4
FIELD : Business, Commerce and Management Studies
SUB FIELD : Finance, Economics and Accounting

PURPOSE:	This Unit Standard is for people who are responsible for controlling the finances of a small business or who are responsible for the bookkeeping aspect of financial management in larger organisations Qualifying learners will be able to: • Distinguish between expenses that are allowable and which aren't allowable as tax rebates/deductions for a sole trader • Calculate capital allowances • Calculate the figures required for the completion of an income tax return • Calculate the tax payable by an individual who is a sole trader • Apply the concepts of limited liability and incorporation to a sole trader.
LEARNING ASSUMED TO BE IN PLACE:	
It is assumed that learners are competent in Communication, Mathematical Literacy and Accounting at NQF Level 3.	

SESSION 1. **Distinguish between the main business expenses that are not allowable for income tax purposes.**
Learning Outcomes:
• The concepts of tax rebates and expenses that are tax deductible are explained using examples from the expenses of a small business. • Expenditure items that are tax deductible and those that are not are identified and listed for a small business for use on a tax return

Tax refund

A tax refund or tax rebate is a refund on taxes when the tax liability is less than the taxes paid. Taxpayers can often get a tax refund on their income tax if the tax they owe is less than the sum of the total amount of the withholding taxes and estimated taxes that they paid, plus the refundable tax credits that they claim. (Tax refunds are money given back at the end of the financial year.)

What is a Tax Rebate?