



Financial

MANAGEMENT



BOOK ELEVEN

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Published by
Department: Agriculture
Private Bag X250
Pretoria
0001

Design, Layout and Illustration by
Dimensional Dynamics

Printed by
Consortium Publishers

ISBN: 1-86871-103-X

BOOK ELEVEN

Outcomes

1

To be able to effectively manage a cooperative financially it is important that you:

- ✓ know what amount is needed in the register as float for each business day
- ✓ control cash received and spend effectively
- ✓ keep book of all transactions that occur in your business
- ✓ understand why statements is important in your business
- ✓ draw up a budget for your cooperative
- ✓ know and understand what auditing entails and what effect it has on your business
- ✓ keep your cooperative's cash flow healthy
- ✓ manage and calculate acceptable credit to members

Introduction

Financial management can be described as a process of communication, correction and decision-making. Just like communication between people, your business' bookkeeping system communicates to you what happens in the business and what its needs are. Easier put, it tells you if your business is financially strong or going bankrupt. Without the necessary information received through good financial management, you will not be able to make sound decisions to make sure that your business runs at its full potential.

Financial management ensures that you keep track of the amount of goods you have in stock and when to buy new goods; to whom you sell and at what price; who your debtors are and how much they owe you; who your creditors are and how much you owe them; how much profit you make; if you have a healthy cash flow; and if your business is growing.

Some people might think that it is not necessary to keep record of all this information because they will remember everything. This is wrong. It will never work. For example, Bongani sells chicken feed to a client on credit without keeping record of the transaction. Two months go by and Bongani cannot remember to whom he has sold the chicken feed or how much he has sold and what the client owes him. If he cannot remember this, the client will refuse to pay. Even if he remembers but the client forgot how much he owes, he will refuse to pay without proof of the purchase. Bongani will make a loss.

This booklet will help you to establish a healthy financial system to help you manage your business successfully. Without this information your business may make a loss like Bongani's in the example above.



Cash Control

3

Cash control can be described as the system of keeping record at the counter of all the sales. It is important to keep record of all the money received because that is the only way to prevent and keep track of:

- clients who have paid too much for goods;
- cash shortages where a client has not paid enough for goods; or
- missing or stolen money.

Record of Sales

The safest way of recording all transactions is by writing out a receipt for each transaction. On the receipt the following information is essential:

- The date of the sale
- The price of each item purchased
- The total amount owed

It is not always possible to write down the items sold on the receipt, because sometimes there can be too many items. It can take up too much time. You can give items codes or numbers to keep track of what is sold. For instance, bread can be no. 1 and seeds no. 23.

Remember to give a receipt to the client and make sure to keep a duplicate.

Cash Bank

The cash bank is the money you keep in your cash register or cash box to provide change to clients. This is usually small change to prevent any shortages of change during a transaction. The cash bank is always a fixed amount, for instance R200-00. You must make sure that this money is stored in the safe at the end of each day. The cash bank does not form part of the sales you have made for the day and it does not form part of your profit.



3

Stock

If it is possible, take stock of what you have sold, at least once a month, and check it against the receipts. Through this you will be able to:

- find and correct mistakes on receipts;
- know if goods have been stolen;
- know when to buy new stock; and
- know which goods are top sellers and which don't sell at all.

Cashing up

At the end of each day the following steps are necessary to ensure good cash control:

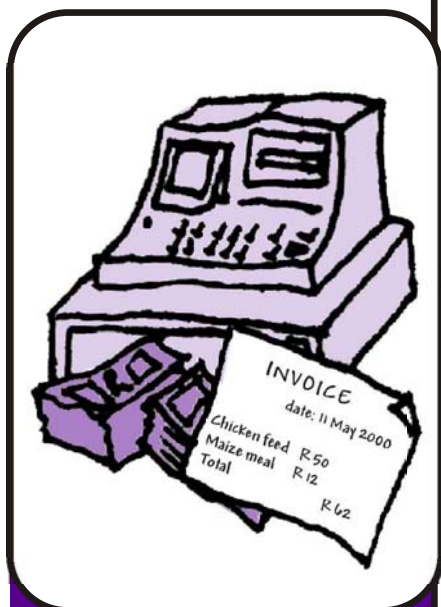
- Take the money for the cash bank out of your cash register and put it in a safe place. Remember, if for example you started with R200-00 in your cash bank, to replace R200-00 at the end of the day.
- Add up the totals of your receipts
- Add up all the money in the register. Remember that the cash bank does not form part of this total.
- The total amount of your receipts should be the same as the amount of money in the register, otherwise you have charged a client too much or too little for goods. Try to find the reason for the mistake and correct it.

Recorded Sales	R 567-32
Cash Received	- <u>R 553-41</u>
Difference (Shortage)	<u>R 13-91</u>

- Write a sales report. A sales report shows if the amount of the receipts and cash register is the same or if there has been an overcharge or shortage.
- Bank the amount received from the cash register.

Cash Control

... continued



Basic Bookkeeping

Bookkeeping as stated earlier is the language of business. Information needed for important decisions, for instance when to buy new stock and drawing up your budget, is communicated to you through bookkeeping. Without this information you will not be able to run your business and it may go bankrupt.

Bookkeeping can be very difficult and it is better to hire an accountant to help you with this process.

An easy way to keep book can be described by looking at the expenses and income incurred to make a profit. For example:

Bongani opens a new business called Bongani's Cash Store on 1 March 2001

- ✓ First, he needs money to buy stock. This could be either a bank loan which he pays off monthly (in instalments), or his own money. This is called capital. Without capital Bongani will not be able to start a business. He takes out a bank loan of R15 000-00 as capital.

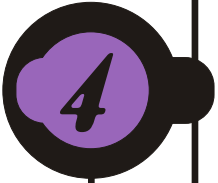
Now Bongani has enough money to buy stock and pay his expenses.

- ✓ Bongani then buys stock for the business which he will sell to his clients. The price of the stock is R10 000-00.
- ✓ Bongani has to pay off the bank loan in instalments of R250-00 per month.
- ✓ Bongani then has to buy equipment he will use in his shop, for instance a new receipt book, pens and price tags. He pays an amount of R250-00 for this equipment.
- ✓ Bongani pays his rent for the premises he is using which is R1 000-00 per month.
- ✓ Bongani pays his workers and his accountant their salaries, which amount to R2 500-00. Remember that his own salary should form part of this amount.

Bongani sells his stock at a profit of 50%. His income on the sales is R15 000-00.

4





To keep record of the month's expenses, Bongani draws up an income statement:

BONGANI'S CASH STORE		
Income Statement for the month ended 31 March 2001		
Income		R 15 000-00
Sale of goods		
Expenses		R 14 000-00
Stock	R 10 000-00	
Instalment on loan	R 250-00	
Equipment	R 250-00	
Rent	R 1 000-00	
Salaries	R 2 500-00	
NETT PROFIT		<u>R 1 000-00</u>

Income:

This is all the money received by the business. Bongani made R15 000-00 by selling his stock.

To know how much income Bongani made through the month he adds all the amounts of his sales reports for March together.

Expenses:

This is all the money paid by the business, such as buying new stock and equipment, and paying salaries. Bongani's expenses for March were R14 000-00.

To calculate your expenses, add up all the expenses for the month. This should be done by adding the invoices you received from the people to whom you have paid money, as well as the salaries you have paid to your workers.

NETT Profit:

This is the profit Bongani made in March.

To calculate the NETT profit, subtract all the expenses from the income you received.

In the example above, Bongani calculates his profit as follows:

$$\begin{array}{r} \text{R15 000-00 (income)} \\ - \text{R14 000-00 (expenses)} \\ \hline \text{R 1 000-00} \end{array}$$

Bongani made a NETT profit of R1 000-00.

Budgeting

5

Look at the example above. What will happen if Bongani's expenses are more than his income? He will make a loss and may go bankrupt! Therefore, budgeting is very important to prevent a loss. It can be described as the essence of good financial management.

To draw up a budget is quite easy if you ask yourself the following questions:

(i) Do I have a market?

Make sure you sell what the customers want. If your clients don't need the goods, they will never buy it. Goods that don't sell can be regarded as a loss because eventually you will have to throw it away.

Try to estimate the size of your market.

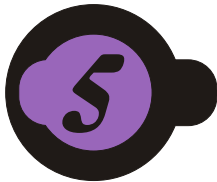
For instance: How many clients do you have that will buy seeds? It is important that you have enough seeds in stock to sell to clients otherwise you will lose out on sales if you can't supply enough. It is also true that if you have too many seeds in stock that it may be regarded as a loss.

(ii) Do I listen to the client's needs?

Input from your clients is very important to estimate what type and how many goods you need. You can get this kind of information through market research. Give your clients a questionnaire about the type of products in which they are interested, specific brands, how much they will need etc.

Sometimes you don't have enough stock of a certain item. For instance, a severe drought has hit the country and there is a shortage of maize. Make sure to stock up on enough maize to sell to clients. You will be able to make a large profit if no one else can sell maize.





For example: Bongani sells maize. He does market research and realises that each client needs at least 1 bag of maize each month. Bongani knows that about 300 clients buy maize from him. This means he will definitely sell 300 bags. But what about new clients that may want to buy maize from him and what if some of his clients want to buy more than 1 bag? Bongani decides to buy 350 bags of maize to sell to clients because he knows he will not run out of stock and he will have ample stock to sell to new clients. He will buy the maize from a farmer for R 50-00 per bag. His maize stock will cost him R17 500-00.

(iii) What equipment and facilities do I need to run my business effectively?

In other words, do you have to rent a premises, do you need a cash register, how much will you pay in salaries and do you need machinery to package and price your goods?

Make a list of all the equipment and facilities you will need and their cost.

For example:

List of equipment and facilities needed:

Rent for premises	R1 000-00
Equipment	R2 250-00
Water & electricity	R 200-00
Salaries & wages	R2 500-00
Stationery (pens and receipt books)	R 250-00
Payment on bank loan	R 250-00
	<u>R6 450-00</u>

A few helpful hints:

- Do not buy equipment which is unnecessary.
- Make sure the equipment you buy is not too expensive.
- Try to buy the equipment you need at the best reasonable price.
- Only employ the personnel you really need.

(iv) Will I make a profit?

It is important to make a profit in order to buy more stock and equipment. Another name for NETT profit is surplus. Without surplus you will be unable to buy stock or let your business grow and you will go bankrupt.

How do you determine your profit? This is really easy. Look at the following example:

Bongani buys stock to the amount of R17 500-00.
He looks at the list of equipment and facilities needed. This amounts to R6 400-00.
Bongani knows he should sell his goods at such a price to make up the cost of his stock and the cost of his equipment and facilities. Thus the price should not be less than the total of this amount, which is:

$$R17\ 500-00 + R6\ 400-00 = \underline{R\ 23\ 900}$$

The price at which he sells the stock cannot be too high, because the stock will then be too expensive and the clients won't buy it. Bongani should make sure the price is realistic. He decides to sell his stock for R24 500-00.

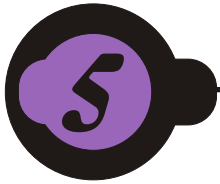
If his stock consisted of 350 bags of maize and he bought it at R50-00 per bag, it would mean he would have to sell each bag for R70-00 each.

Bongani knows this price is realistic and not too high.

The income from the sale of stock will therefore be R24 500-00.



Budgeting
... continued



Bongani now wants to know what his NETT profit will be. This he determines by subtracting all the costs from the income he has received.

$$\begin{array}{r} \text{R}24\,500\text{-}00 \quad (\text{income}) \\ - \text{R}23\,900\text{-}00 \quad (\text{costs}) \\ \hline \text{R} \quad 600\text{-}00 \end{array}$$

NETT profit (surplus) is necessary for every business to grow. With this money you can buy more stock and expand your business. Bongani does not put this money into his own pocket. He uses it to reinvest in the business to ensure his business reaches its full potential.

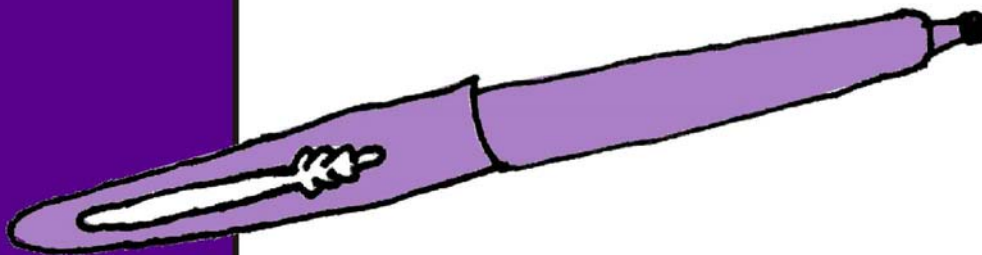
(v) Where do I find capital?

Capital is the money needed to start your own business? Without capital you won't be able to buy equipment or stock, or to pay salaries and the rent for your premises.

By budgeting as explained above you will know how much money you need to finance your business during the first month. As in the example, Bongani needs money to cover his first month's costs, which is R23 900-00.

Bongani can get the capital needed for his business by taking out a bank loan or providing the money to the business out of his own pocket.

Bongani gets a loan from the bank to cover his initial costs. Remember that Bongani has to pay off this loan at R250-00 per month. This payment forms part of the costs. Remember to keep book of all your debts and credits.



Budgeting... continued

The Balance Sheet



The balance sheet gives you an overview of your capital (what is the source of your capital) and how you have used the capital in your business. How to draw up a balance sheet can be shown by the following example:

Bongani wants to start his own business.

- He invests R500-00 in the business out of his own pocket. This is called entrepreneurial capital.
- He gets a loan from ABC Bank for R23 900-00 to finance his business with.
- Bongani buys stock for R17 500-00 to sell to his clients.
- He buys equipment for R2 250-00.
- Bongani now has R4 650-00 left to pay his rent, salaries and other costs.

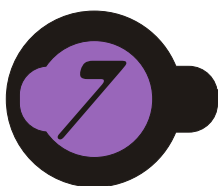
The balance sheet:

Bongani's Cash Store			
Use of Capital		Source of Capital	
Stock	R 17 500-00	Share capital	R 500-00
Equipment	R 2 250-00	Loan:	
Cash	<u>R 4 650-00</u>	ABC Bank	<u>R 23 900-00</u>
Total	R 24 400-00	Total	R 24 400-00

You will note that the totals at the end of the columns are the same. Now Bongani knows for what purposes the capital was used and that no money is missing or misspent.

The balance sheet changes daily. Bongani sells R1 000-00 of his stock. The total amount of stock he has will now be R16 500-00. At the same time he receives the cash for it. The cash will then increase from R4 650-00 to R5 650-00.

Note that the totals still stay the same and will not change. Also note that your NETT profit does not form part of your balance sheet.



Auditing

Auditing can provide a cooperative with the necessary information to avoid potential problems that could weaken the cooperative's financial position. Usually an accountant is responsible for the audits in a cooperative. Through drawing up statements (as explained above), you can get a clear picture of your cooperative's financial status.

Income statements should be drawn up at least twice a month and a balance sheet at least once every month. The more times you check your cooperative's financial status each month, the better you will be informed about what is happening to all the money in the cooperative.

Audits are the only sure way to estimate cash flow and to make sure that your cooperative's resources are used to their full potential. Without the necessary cash in hand with which to conduct business, you will be unable to buy new stock or equipment to make a profit. Your cooperative will eventually go bankrupt.



Cash Flow



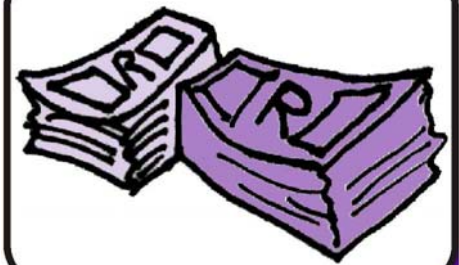
Understanding cash flow is essential to stay in business. You have survived your first month with the help of the capital you put into the business. Now what to do in the months to come?

Do audits timely and do not neglect updating them. Through this you will know how much cash is still owed to you and how much you have in hand to pay your costs and buy new stock.

Note that you need enough cash in hand to let your cooperative run effectively. In other words make sure that your cooperative's cash flow is always healthy.

To make sure that there exists a healthy cash flow in your business, you should follow the next few simple guidelines:

- Do a self-audit to make sure how much cash is available in your business. Look at how much money you have in the bank and also how much money you have available for immediate use.
- Draw up a budget of how much money you will spend in the next month and what your income will be. The budget should be conservative without any high expectations of what might happen. If your expectations are too high and they are not met, your business could go bankrupt. If there is any money left over in your budget, determine how you can use it to let your business grow. Remember to set reasonable expectations at all times.
- When you purchase stock it helps to know when it will be delivered to you. For example: Bongani buys seed for R15 000-00 from XYZ Supplies. Although he has already given them the money, they don't have enough seed in stock to deliver to him immediately. They will only be able to supply seed in three month's time. Now Bongani has a problem: he does not have enough money to buy other stock to sell to his clients in these three months. How will he make a profit and pay his costs if he has nothing to sell? Bongani could go bankrupt. To avoid this, arrange to pay for the goods only after they have been delivered to you.





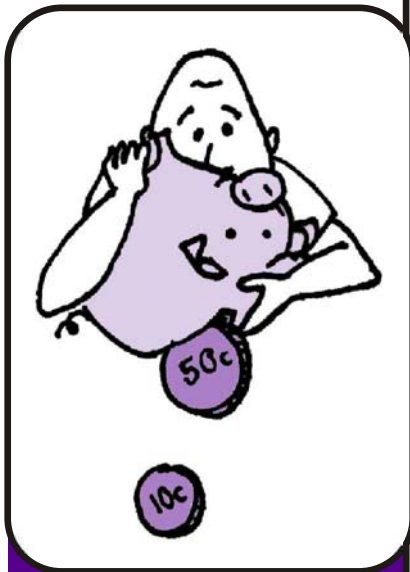
- There is a misconception that the largest part of your income will be through cash sales. In fact most income generated is by selling goods to clients on credit. This may sound easy, but it could become a big problem for businesses these days.
- While your clients still owe you money, it means that you might not have enough money to buy stock or to pay your bills. Make sure you have an effective system to pressure slow-paying clients sooner to get the outstanding money on time.
- Keep record of what you owe to your suppliers and other companies. Late payments may earn you a penalty amount, a lawsuit or a cancellation of a loan, which you then have to refund immediately in full.

To keep track of whom you have to pay and when you have to pay them, create a schedule of recurring expenses. For example:

Company	Date of payment
ABC Bank (loan payment)	The 1 st of each month
Rent for premises	The 2 nd of each month
Water & electricity	The 11 th of each month
Salaries	The 25 th of each month

This schedule can identify which bills you can pay later and which should be paid immediately.

- Always try to have enough cash available to pay your expenses. Avoid taking out extra loans to finance your business because of cash shortages. Try to find a solution that will solve such a crisis in future. Use your own initiative to find ways of optimising your cash.



Cash Flow

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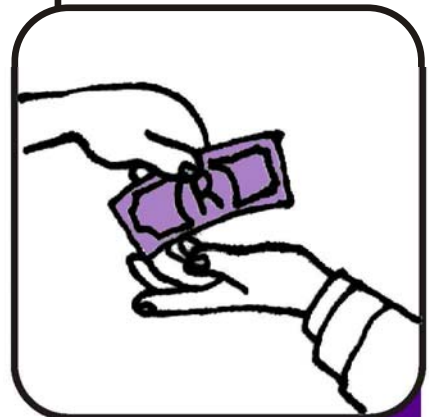
Debtors & Creditors

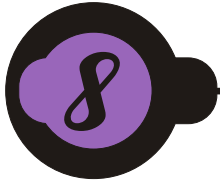


Debtors

A debtor can be described as a person or company that owes you money. This is usually a client that buys goods from you on credit. Most businesses don't like to sell goods on credit to clients because it may be detrimental to their cash flow. Cash sales are always the safest way of income. If you are willing and able to sell goods on credit, you should take the following into consideration:

- Always try to have enough cash available to pay your expenses. Avoid taking out extra loans to finance your business because of cash shortages. Try to find a solution that will solve such a crisis in future. Use your own initiative to find ways of optimising your cash.
- Look at your budget and make sure there is enough surplus cash available (money that is not needed to pay immediate costs).
- Look at who your frequent and best paying clients are. Only they will be eligible to buy on credit.
- Work out a credit limit and a time schedule of payment.
- Only provide credit if a client asks for it and when you are sure that he will repay you according to the time schedule. The client should fill out an application form, providing you with all his personal information and banking details. Check his credit record to see if he will be able to repay you.
- Work out interest on the goods sold on credit. Because the client pays later for the goods and you carry the risk of the client not paying, he will have to repay you a percentage more for the goods.
- Make sure that every time a client buys on credit that he signs a form which stipulates the following:
 - * The date of the purchase
 - * The total price of the purchased goods
 - * The client accepts that he owes you this amount
 - * The client will pay you according to schedule
 - * You will charge extra interest on late payment





Make a list of your debtors and what they owe you. Also write down each payment they make. For example:

Client	Date	Outstanding	Payment
CM Maphela	2 March	R 150-00	
	20 March		R 75-00
	2 April		R 75-00

Remember that by subtracting the payment from the outstanding amount, you will be able to see how much the client owes you. Thus after CM Maphela's last payment, he owes you nothing.

Also remember to add up all your debtors' outstanding amounts to see how much money they owe you in total. It is your responsibility to make sure the debtors pay on time.

Creditors

A creditor is a person or company whom you owe money to. Make sure that you have a healthy cash flow to repay the creditor on schedule. If you do not pay on time the creditor may charge extra interest on the amount you owe him. He may even cancel your credit facilities, in which case you will have to pay the outstanding amount in full.

Also keep record of your creditors as follows:

List of creditors

Company	Date	Owing	Payment
XYZ Supplies	1 March	R 5000-00	
	1 April		R 1500-00
	1 May		R 1500-00

By subtracting the payments from what you owe, you will know how much is still outstanding. Remember that you may pay off your creditors earlier than is expected of you. By doing that you will save a lot of money on interest and maybe get a discount.

Debtors & Creditors ... continued

Assessment

10

1. The following sales were made by Friendly Co-op on 5 August 1998. (Note that the following prices apply: bread is R3-00 and an apple is 50c):

Ms Kumalo bought 2 breads and paid R6-00 for it. Solomon paid 50c for a juicy apple. Nandi bought 1 bread and 1 apple. She paid R4-00 in total for these items. Kate bought 2 breads and 3 apples and paid R7-50. Makenza bought 5 apples and paid for it with a R10-00 note. He received R8-50 change.

Use the above transactions to describe cash control as well as the procedure that should be followed to ensure that cash control is always effective. Are there any mistakes in the transactions made above? Describe how mistakes are remedied.

2. Which questions should be asked when you plan to start your own business?
3. Bongani opens a grocery store on 1 April 2000 and has R15 000-00 in hand. The following expenses will occur at the beginning of the month.

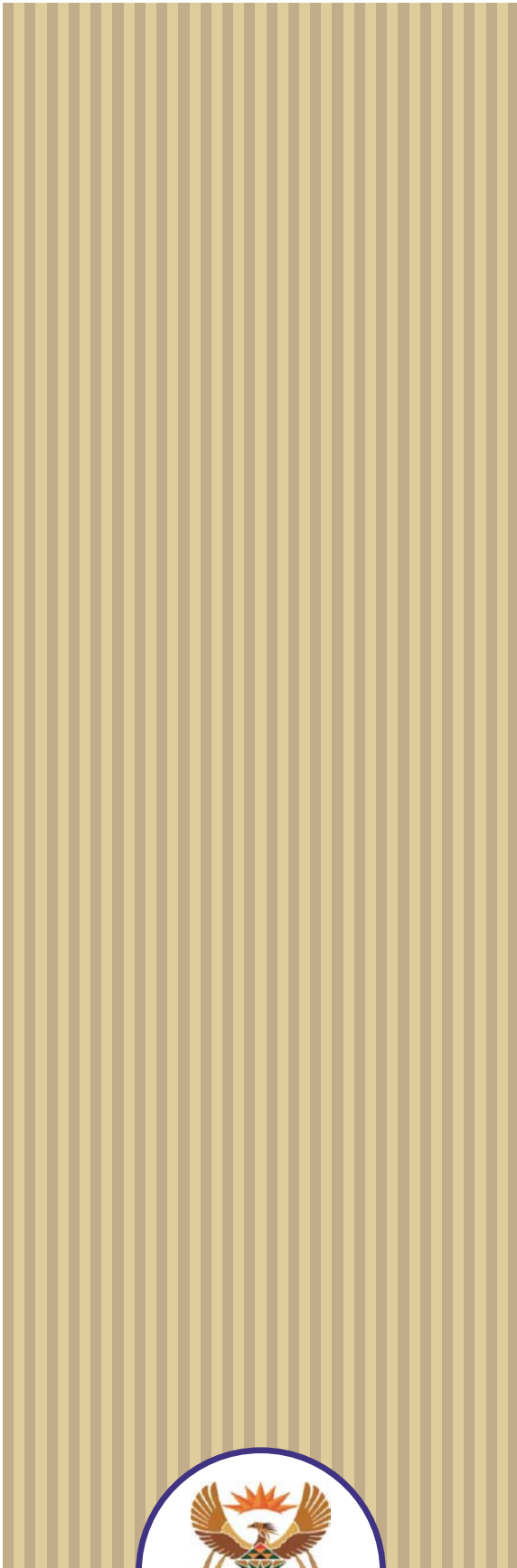
Rent:	R 1 000-00	(Paid on 1 April)
Equipment:	R 3 000-00	(Bought on 3 April)
Stock:	R10 000-00	(Bought on 5 April)
Electricity bill:	R 500-00	(Paid on 28 April)
Telephone:	R 500-00	(Paid on 28 April)

Work out a budget and profit margin for Bongani to ensure that he has enough money to continue with business the next month.

4. Look at the transactions in number 3 above. Let's say the following transactions did also occur in April:
 - * The R15 000 in hand above in share capital
 - * Bongani also takes out a further loan of R35 000-00 from XYZ Bank and pays it off in monthly instalments of R2 500 per month.
 - * Bongani buys stationery worth R150-00 on 27 April for bookkeeping.

Draw up an income statement for April using the transactions in 3 and 4 as basis. Also draw up a balance sheet for April.

5. Discuss the importance of statements.
6. How can you keep track of debtors and creditors?



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