Economic and Management Sciences

Grade 7

Term 2

FINANCIAL LITERACY

Topic 5: Accounting Concepts

There are certain basic accounting concepts that are used throughout the business world. It is important to have a basic understanding of these concepts whether you plan to be an entrepreneur, an accountant, work in the business world one day or whether you simply want to manage your personal finance, saving and investments effectively.

FINANCIAL LITERACY

ACCOUNTING CONCEPTS

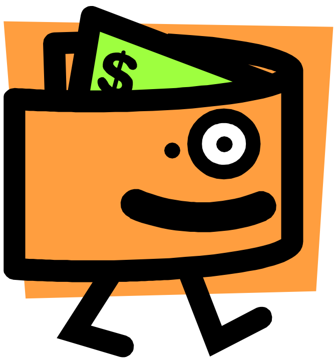
- capital
- assets
- liability
- income
- expenses
- profit
- losses
- budgets
- savings
- banking
- financial records
- transactions

INCOME & EXPENSES

- personal income
- personal expenses
- personal statement
- net worth
- business income
- business expense
- business savings and investments

BUDGETS

- definition
- income
- expenditure
- personal budget
- business budget



Lesson 1

Capital, assets and liabilities

Capital, assets and liabilities are the basic concepts in financial literacy. **Assets are what the business owns and liabilities are what it owes.** For any business to be successful, it must have access to capital.

✓ Capital

Capital is all the money, goods and property a business can use to make an income through the activities of the business (buying, producing and selling)

There are five main types of capital:

- Fixed capital or physical capital is the goods used to produce other goods that satisfy our needs and wants. Fixed capital includes machines, tools, factory buildings, office buildings and trucks/vans.
- Financial capital is the source of money (funds) Example: Someone who starts a factory usually borrows money to rent premises and to buy machines, tools and raw materials (capital goods).
- Share capital is the money invested by the owners in the business. It provides the funds to buy fixed capital goods.
- Working capital or operating capital is needed to run the business from day to day. It does not include fixed capital.
- Start up capital is the money needed to start a new business.

Activity 1

1. Explain what the term ‘Capital’ means.
2. There are 5 different types of capital. In your own words, explain each of the different types and include an example.
3. You are starting a small manufacturing business that will make and sell wooden toys. Draw a table like the one on page 3 and complete it by deciding whether the items listed below the table template are part of your working capital or your fixed capital.

Capital needs	Cost	Working Capital	Fixed Capital

- carpentry workshop and store
- cash in the store's till
- stock of chairs, tables and cupboards
- wood, nails, paint and wood glue
- saws, hammers and paintbrushes
- electricity saw, plane and sander
- delivery truck
- people who bought furniture on credit
- bank account

Lesson 2

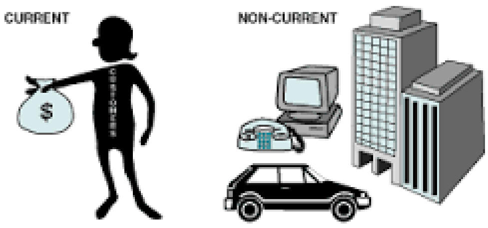
Assets

Assets are the items that have monetary value and are owned by the business. They may include the amounts of money that customers owe to the business (debtors) or that is in the bank account of the business. Assets also include physical assets like raw materials, machinery and inventory (stock).

There are two types of assets:

Non-current assets – will not be converted into cash within the next year (accounting period). Examples include land and buildings, vehicles, equipment and investments.

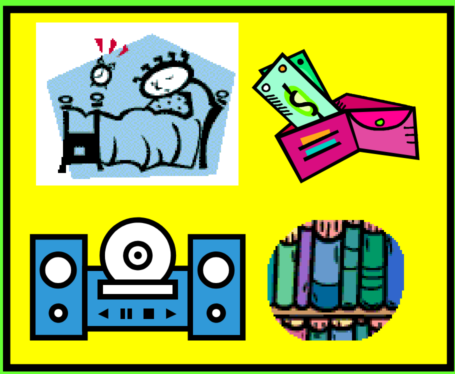
Current assets – can be converted into cash within the next year (accounting period). Examples include inventories, debtors and cash in the bank.



Activity 2

Calculating assets

David is a Grade 7 learner. He would like to draw up a list to see how wealthy he is. He has looked around his bedroom to decide what belongs to him. His parents told him that certain assets are his, such as his bed, table and chair. He also owns other things, or assets, which were either birthday presents or items bought with his pocket money. These are the items he now has in his possession:



Furniture in his room: R 2 300

Radio with CD player: R550

Cash in his wallet: R50

Clothes: R3 000

Books: R200

Savings account at the bank: R625

Two neighbours in his street owe him R60 each for sweeping their yards.

a) Prepare a list to calculate David's total assets.

b) Use the list created to classify each item as a fixed or a current asset

Lesson 3

Liabilities

Liabilities are monies owed, by the business, to other people or other businesses (creditors). Liabilities include the amounts of capital that were either borrowed from the bank or equity. This is the money that the business owners provided, as well as any reserves the business has.

There are two types of liabilities:

Non-current liabilities - are long-term costs such as mortgage/bond or loan repayments.

Current liabilities - include creditors and the bank overdraft, which is a short term loan from the bank when you run out of cash.

Activity 3

Calculating liabilities:

1. Make a list and calculate David's total liabilities.
   a. He borrowed R20 from his sister to buy airtime. He owes his father R35, which he has to pay back by the end of the month.
   b. He borrowed R2 400 from his uncle to buy his bicycle. David pays his uncle back R100 per month over two years.
2. Use the list of liabilities to classify each item as either a current liability or a non-current liability. Give a reason why you have classified each item the way you have. Draw this table in your book.

Current Liability	Non-current liability

3. Are the following assets or liabilities? Complete your answer in a table. Draw the table in your book.

A building, a telephone account, a telephone, rental for a storeroom, money in a savings account.

Assets	Liabilities

Lesson 4

In a business, money comes in (income) and goes out (expense). To make a profit, your income needs to be greater than your expenses. If your expenses are greater than your income, your business is operating at a loss (it is losing money).

Expenses

An expense is payment for services and consumable goods that the business buys in order to keep the business running. Expenses decrease the owner's equity in the business. Expenses are items which have no lasting value. They are not assets.

Fixed expenses are the costs that you have to pay every month no matter how many products or services you provide. Fixed expenses are also known as overhead expenses of a business. Fixed costs include: rent you need to pay for the premises, telephone accounts, water and electricity, salaries and monthly wages.

Variable (non-fixed) expenses are the costs that relate to the amount of products and services the business provides. Variable expenses increase if more products and services are provided and decrease if fewer products and services are provided. For example, the cost of raw materials and packaging used will depend on the number of products manufactured. Variable costs include payments you have to make for: raw materials, wages (if workers are employed only when production takes place and they are paid an hourly rate), completed products, advertising, stationery and repairs.

Activity 4

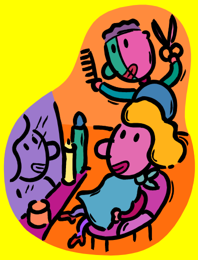
Look at the following pictures of products and services.

For each of the pictures, list 8 costs involved in the production process.

Indicate which are fixed costs, and which are variable costs.

A bakery

A furniture maker



A hairdresser

Fizzy Drinks Company

REMINDER – B ring in magazines / newspapers for Lesson 5

Lesson 5

Income

Income is all the money that the business earns. A trading and manufacturing business's main form of income will be from sales, while a service business will earn its main income charging customers a fee for services offered.

Income refers to items that have a positive effect on a person's net worth. They can either increase an asset or decrease a liability. Income increases the owner's profit and can therefore also the owner's equity in a business.

Other types of income include interest income, discounts and rent income.

Activity 5

Collage of accounting concepts

Create a collage in your workbooks, using pictures from magazines, newspapers or your own drawings, to illustrate different types of assets, liabilities, income and expenses. Ensure that your pictures have labels to point out the different concepts.

Lesson 6

Profit and Loss

✓ **Profit**

Profit is the money a business makes after taking all the income and deducting all the expenses. The aim of any business is to make a profit. This is called a profit motive.

Profit can be seen as payment for the services rendered by the business, or for the entrepreneurship displayed by the owner and for taking the risk to invest money in the business. Some articles have a low profit margin, especially when they sell quickly (high turnover), e.g. groceries. Others, which sell slowly, e.g. furniture, have a higher profit margin. The profit must be such that the business:

- can compete with other businesses
- covers all expenses
- gets a fair income

Any profit that is gained goes to the business owners, who may or may not decide to spend it on the business.

Profit is calculated as follows:

Income – Expenses = Profit

Loss

A loss can be described as the loss of money or decrease in the financial value. A net loss in a business is when the expenses are more than the income earned in a certain period. A loss can also occur when a business sells an asset for less than it is worth. Any loss that takes place will decrease the owner's interest in the business.

When we talk about how much money a business has made during a specific period, we could say that the business:

- shows a profit (made money)
- ran at a loss (lost money)
- breaks even (has not made or lost any money. In other words, the business has earned exactly what it cost them to produce the goods or provide the service.)

Activity 6

Rewrite the following sentences in your book, and fill in the answers, using the words listed below.

1. ____________ __________ are loans which are payable over a number of years.
2. Goods that we own are called our _______________.
3. The interest or share that an owner has in his business is called ________ ________.
4. ___________ is the money the business earns.
5. Money that is owed to creditors is a __________ __________ for the business.
6. When money is spent on wages, it is an ____________ for the business.
7. The money the owner uses to start a business is called _______________.
8. Vehicles and equipment are examples of _____________ .
9. ____________ ___________ are only temporary of nature and can be converted into cash quite easily, usually within a short period of time.
10. The aim of any business is to make a profit, this is referred to as the _______ ______.
11. A loss can be described as a loss of money or a decrease in ________ _________.

owner's equity   income   capital   current assets   expense
Long-term or non-current liability   assets   debt   fixed assets
financial value   current liability   profit motive

Calculate profit, loss and break even point

Copy the following table and complete these calculations to show if the companies made a profit, ran at a loss or broke even. Use the formula: Income – Expenses = Profit

Income	Cost	Profit / Loss
1) R2 000	R 349	
2) R400	R 425	
3) R9 000	R11 250	
4) R7 000	R 780	

Lesson 7




Budgets

A budget is a written plan on how to spend future income. It is a written document showing the planned income and the estimated expenses of a persons or a business for a specific period of time in the future, for instance, a month or a year. Individuals, as well as businesses should draw up budgets to spend money wisely and make savings where possible.

Families prepare a monthly budget for their income and expenditure. When you have a plan for how your money and resources will be allocated, you can ensure that you do not spend more than you earn. Essential expenses such as rent, food and electricity should be paid first. Then, some money can be put aside to save for major expenses, such as furniture or a car.

Government budgets for their tax income (revenue) and expenditure in a national budget. Businesses use budgets to plan and control their operations and activities. A budget shows how resources are expected to be acquired and used during a specific period.

Budgeting is an essential part of managing a business because the budget information is used throughout the management process. Managers prepare forecasts, which are estimates of money coming in (receipts) and money going out (payments).

The forecasts need to be as accurate as possible and the transaction patterns of the previous years must be taken into account. Budgets should be checked and updated regularly, to enable managers to control receipts and payments.

Savings

Saving is the act of putting money aside for future use. You can only save if you do not spend all the income earned. Money can be saved in a bank or any other financial institution that offers savings facilities. Trying to spend less on some unnecessary expenses, like luxuries, or trying to cut down on expenses, like water and electricity, can also be seen as a form of saving. People who save put money aside for things they need to pay for in the future, such as education, a deposit on a house, a car or even travelling. They also have money for emergencies, such as car accidents, illness or unemployment.

You can save money by doing the following:

- Never spend more than the amount you earn
- Think about buying what you need first. Pay off all your debt and stay out of debt
- Always have cash to buy the basic things you need
- Keep some emergency funds for doctors, vets, vehicles, house costs and other bills
- Learn from that past and plan for the future
- Make long term goals.

Activity 7

Imagine that you have just won R1 million on the lottery! What are you going to do with all that money?

1) Draw a mind map on what you 'need' and what you 'want'.
2) Work out a budget detailing how much money you would need every month, every year and into the future, to fulfil your needs and wants. Write the budget information under two columns called **'Spend'** and **'Save'**
3) Work out how much money you could put aside to follow your dreams and to help others. Write one paragraph (8-10 lines) to explain what you would do, and explain your reasons.
4) Write one paragraph (8-10 lines) about how you would like to save part of your R1 million wisely.

Lesson 8

Transactions

A transaction is a financial action or event that takes place in a business. A transaction has at least two interested parties, i.e. the buyer and a seller. Transactions must be recorded and these receipts and slips are called source documents. When two parties take part in a transaction, they do business by exchanging money or something of value for example:

The business sells goods for cash to a customer:	**The business buys** goods from a supplier for cash:
Two parties: business and customer Business exchanges goods for cash Customers exchange cash for goods	Two parties: business and supplier Business exchanges goods for cash Customers exchange cash for goods

Two types of transactions can take place:

- Cash transaction (cash receipts and cash payments)
- Credit transactions (credit purchases and credit sales)

Transactions are recorded in the journals and ledgers of a business (book). The following information is necessary from the source document when recording a transaction in the books of a business:

- The date of the transaction
- The parties involved in the transaction
- The amount of money involved
- The reason for the transaction

Financial Records

All businesses need to record financial transactions in the accounting systems of business. This is called keeping financial records.

Every financial transaction must be recorded in an orderly and systematic way. This is called book-keeping. Amounts, dates and sources of every transaction must be correctly recorded into an accounting system and summarised for the following reasons:

- To ensure the effective daily running of the business.
- To work out if the business has made a profit or a loss.
- To plan for a future.
- To work out how much money is owed to other parties.

Financial statements are prepared to communicate the financial results of the business to interested parties. There are a number of people or institutions that may be interested in the financial statements of the business. Examples:

• Owners of the business	• Potential buyers of the business
• SARS	• Managers and senior personnel
• Employees and trade unions	• Creditors or suppliers who grant credit to the business
• Banks and other financial services	

Activity 8 (a)

Match the users of the financial statements (Column A) with why they are interested in the financial statements (Column B). Write your answers into your workbooks.

Column A	Column B
1. Partners of the business	To make sure that the business is paying Value Added Tax) VAT on a regular basis and that the partners are paying income tax on their earnings.
2. South African Revenue Services (SARS)	To see which institutions lend money to the business and to make sure the business has the ability to repay its loans, bank overdrafts and have enough security to guarantee it.
3. Employees and trade unions	To make sure the business can pay its debts and that the business is credit worthy.
4. Banks and other financial services	To determine if their investment in the business is profitable.
5. A potential buyer of the business	The information reflects day to day information that can be used for problem solving.
6. Managers and senior	To see if the business has a positive profit trend and that it continues to justify more investment.
7. Creditors and suppliers	They can use it as a tool to negotiate salary or wage increases and better working conditions.

Activity 8 (b)

Practical Task - Visit a business

Visit any formal or informal business in your community or speak to a business owner and gather information on the following:

- Examples of different types of transactions that take place in the business on a daily basis.
- How they record their financial transactions.
- What type of accounting system they use.

You need to prepare a short oral presentation (5 min) giving feedback on your findings.

B