Fetola Small Business Workshop: Demystifying Accounting

FETOLA

In Association with Pick n Pay

TOPICS OF DISCUSSION

- Financial Statements
- Importance of Cash Flow
- Cash Flow vs. Profit
- Working Capital Cycle
- Managing Debtors
- Managing Suppliers
- Managing Inventory (Stock)

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FINANCIAL STATEMENTS

- **Statement of Financial Position (Balance Sheet)**
  - Statement of Assets (Things that you own that generate Income)
  - Less Liabilities (Money that you owe)
  - Difference = Net Worth or Capital

- **Statement of Comprehensive Income (Income statement)**
  - Revenue/Sales (INFLOW)
  - Less Expenses (OUTFLOW)
  - Difference = PROFIT

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Example of an Income Statement and Balance Sheet

Statement of comprehensive income		
for the year ended 28 February 2010		
	2010	2009
Revenue	**800,000**	**600,000**
Turnover	800,000	600,000
Cost of merchandise sold	-650,000	-480,000
Gross profit	150,000	120,000
Trading expenses	-85,000	-77,000
Employee costs	-50,000	-45,000
Occupancy	-20,000	-18,000
Operations	-15,000	-14,000
Trading profit/(loss)	65,000	43,000
Profit/(loss) before tax	65,000	43,000
Tax	-19,500	-12,900
Total comprehensive income	45,500	30,100

Statement of Financial Position		
as at 28 February 2010		
	2010	2009
Assets		
Non-current assets		
Equipment and Vehicles	125,000	100,000
	125,000	100,000
Current Assets		
Inventory	55,000	50,000
Trade and other receivables	25,000	27,000
Cash and cash equivalents	30,000	29,500
	110,000	106,500
Total Assets	235,000	206,500
Equity and liabilities		
Capital and reserves		
Capital	15,000	15,000
Accumulated profits	75,600	30,100
Total Equity	90,600	45,100
Non-current liabilities		
Long term debt	79,900	107,000
	79,900	107,000
Current liabilities		
Tax	19,500	12,900
Trade and other payables	45,000	41,500
	64,500	54,400
Total equity and liabilities	235,000	206,500

FINANCIAL STATEMENTS (Continue)

- **Cash Flow Statement**
  - Most important Financial Statement of all
  - Shows:
    - How Cash balances have gone up and down
    - Why this happened
    - Where this happened

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Example of a Cash Flow Statement

Cash Flow Statement		
for the year ended 28 February 2010		
	2010	**2009**
Cash flow from operating activities		
Trading profit	65,000	43,000
Depreciation	15,000	14,000
Cash generated before movement		
in working capital	**80,000**	**57,000**
Movements in working capital	**500**	**-35,500**
Increase/(Decrease) in creditors	3,500	41,500
(Increase)/Decrease in inventory	-5,000	-50,000
(Increase)/Decrease in debtors	2,000	-27,000
Cash generated by operations	**80,500**	**21,500**
Tax paid	-12,900	-
Total net cash from operating activities	**67,600**	**21,500**
Cash flow from investing activities		
Investment in equipment and vehicles	-25,000	-100,000
Total net cash ustilised in investing activities	**-25,000**	**-100,000**
Cash flows from financing activities		
Debt raised/(repaid)	-27,100	107,000
Capital injected	-	15,000
Net cash (utilised in)/from financing activities	**-27,100**	**122,000**
Net (decrease)/increase in cash and cash equivalents	**500**	**29,500**
Cash and cash equivalents at 1 March	29,500	-
Cash and Cash equivalents at 28 February	**30,000**	**29,500**

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IMPORTANCE OF CASH FLOW

- When planning the short- or long-term funding requirements of a business, it is more important to forecast the likely cash requirements than to project profitability.
- Whilst profit, the difference between sales and costs within a specified period, is a vital indicator of the performance of a business, the generation of a profit does not necessarily guarantee its development, or even the survival.

- **Bear in mind that more businesses fail for lack of cash than for want of profit.**

CASH FLOW VS. PROFIT

- Profit does not necessarily coincide with cash in and out flows
- Sales might be secured and goods delivered, but payment might only occur later if credit was given to the customer
- Payments must also be made to suppliers, staff etc
- Cash may also be invested in rebuilding depleted inventory or purchasing new equipment etc
- The net result is that cash receipts often lag cash payments
- The business might show generated profit but may experience a short term cash shortfall

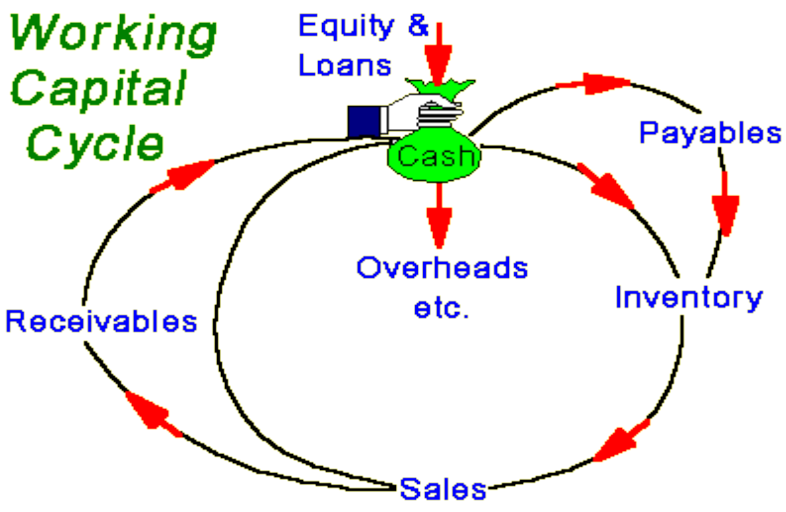
CASH FLOW VS. PROFIT

- The following simplified example illustrated the differences between cash and profit

Income Statement:	Month 1
Sales (R000)	75
Costs (R000)	65
Profit (R000)	10

Cashflows relating to Month 1:	Month 1	Month 2	Month 3	Total
Receipts from sales (R000)	20	35	20	75
Payments to suppliers etc. (R000)	40	20	5	65
Net cash flow (R000)	-20	15	15	10
Cumulative net cash flow (R000)	-20	-5	10	10

WORKING CAPITAL CYCLE



If you	*Then ......*
•Collect debtors faster	You increase your cash resources
•Collect debtors slower	You decrease your cash resources
•Get better credit (in terms of duration or amount) from suppliers	You increase your cash resources
•Move stock faster	You increase your cash resources
•Move stock slower	You decrease your cash resources

- By getting cash to flow faster through this cycle you can:
  - Reduce the need to borrow money
  - Reduce finance charges
  - Have free money to support additional sales growth

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MANAGING DEBTORS

- Slow payment has a crippling effect on business, in particular on small businesses who can least afford it. If you don't manage debtors, they will begin to manage your business as you will gradually lose control due to reduced cash flow and, of course, you could experience an increased incidence of bad debt.

- Debtors due over 60 days (unless within agreed credit terms) should generally demand immediate attention.

- There is nothing more important than getting paid for your product or service. A customer who does not pay is not a customer.

MANAGING SUPPLIERS

- Purchasing initiates cash outflows and an over-zealous purchasing function can create liquidity problems.
  - Who authorises purchasing in your company?
  - Are purchases geared to demand forecasts?
  - Do you have alternate sources of supply
  - Have you negotiated trading terms with you suppliers?
- Pay only for the goods that you received at the price that you agreed
- If you pay cash for stock from a supplier always negotiate a discount (Beware of the opposite – if you have terms rather ask for a longer payment term)

MANAGING INVENTORY

- Managing inventory is a juggling act
  - Excessive stocks can place a heavy burden on the cash resources of a business.
  - Insufficient stocks can result in lost sales, delays for customers
- The key is to know how quickly your overall inventory turns, taking the nature of the business into consideration.
- The key issue for a business is to identify the fast and slow stock movers with the objective of establishing optimum stock levels for each category and, thereby, minimize the cash tied up in stocks.
- Higher than necessary stock levels tie up cash and cost more in insurance, holding costs and interest charges.
- Buy what you sell DON'T sell what you buy
  - Know what sells and have that in stock rather than having to mark down stock that does not sell

CLOSING REMARKS

- **KNOW WHAT YOU WANT TO BE, SET CLEAR GOALS AND STICK TO THEM**

- **PRUDENCY IN A BUSINESS IS TO KNOW WHAT YOU OWE AND NOT WHAT YOU OWN**

Thank You