

FINANCIAL LITERACY - MEMORANDUM

TOPIC 2: INCOME AND EXPENSES

Teachers notes – see Addendum for learner’s handouts

Activity 1

1. Match column A with column B and write the correct letter in column C:

Column A	Column B	Column C
1. Expense	a. Money received by you.	1. d
2. Income	b. Items that you own that are worth something when they are sold.	2. a
3. Asset	c. Money that is owed to others.	3. b
4. Liability	d. Money that is paid directly to others.	4. c
5. Current asset	e. Money we owe but will be paid in more than a year.	5. g
6. Current liability	f. Money or value that will be received in more than a year.	6. h
7. Non-current asset	g. Money or value that will be received in less than a year.	7. f
8. Non-current liability	h. Money owed that will be paid within a year.	8. e

2. What is the difference between:

a) An expense and a liability? Give an example of each.

An expense is something that is paid for immediately (e.g. wages paid) and a liability is something that is owed and will only be paid in 1 or more years (e.g. mortgage loan, car loan).

b) An asset and income? Give an example of each.

An asset is something of value that you own and can sell and receive money much later when you have no use for it (e.g. machinery, radio, property). Income is money or value that you receive weekly or monthly for goods sold or when you receive your salary. So, the value that you receive for an asset takes a longer period than receiving your income.

Net Worth

Net worth is the true worth of a business. We work this out: What we own (Assets) less what we owe (Liabilities). Another name for net worth is Owner’s equity. Owner’s equity gives the owner of the business an idea of what the value of the business is or what value the owner will receive. Owner’s equity = Assets – Liabilities

Look at the example. I take a loan out to buy property worth R1,000 000. I owe R400 000 on the property.

$$\begin{aligned} \text{So, Owner's equity} &= \text{Assets} - \text{Liabilities} \\ &= \text{R1 000 000} - \text{R400 000} \\ &= \text{R600 000} \end{aligned}$$

Therefore, I only own R600 000 of the R1,000 000 property. This is Owner's equity. You can also use this equation: $\text{Assets} = \text{Owner's equity} + \text{Liabilities}$

$$\text{R1 000 000} = \text{R600 000} + \text{R400 000}$$



Activity 2 – Amanda's Tuck shop

1. Read the paragraph below and answer the questions that follow (you may use a calculator):

Amanda owns a tuck shop. She bought a wendy house for R10 000 and converted it into a shop. Amanda still owes her Uncle R6000 for the money he lent her for the wendy house. She pays him R500 per month. She also owes a furniture shop R3500, which she pays R400 per month. She has stock to the value of R4400 in her shop.



- a) Work out Amanda's Owners equity (Net worth).
Owner's equity = Assets – Liabilities

$$\text{Assets} = \text{R10 000} + \text{R4 400} = \text{R14 400}$$

$$\text{Liabilities} = \text{R6 000} + \text{R3 500} = \text{R9 500}$$

$$\text{Owner's equity} = \text{R14 400} - \text{R9 500} = \text{R4 900}$$

- b) Do you think Amanda's Owners equity is healthy? Give a reason for your answer.

Learners own answer. Yes, she should be able to pay for her liabilities which is R900 per month and have enough to buy more stock or save or pay more towards her liabilities.

Statement of Net worth: The Balance Sheet

- Businesses usually work out their Owner's equity or net worth using a statement of net worth called the Balance Sheet.
- A Balance Sheet is a financial statement reporting on the company's assets, liabilities and owners equity at a specific point in time.
- The balance sheet shows the assets minus (less) the liabilities of a business to show the Owner's equity.

Or, can be worked out as: $\text{Assets} = \text{Owner's equity} + \text{Liabilities}$.

- The left-hand side (assets) of a balance sheet needs to balance with the right-hand side (liabilities + owner's equity): $\text{Assets} = \text{Liabilities} + \text{Owner's equity}$.
- Assets should be worth more than Liabilities to have a healthy business.

E.g.

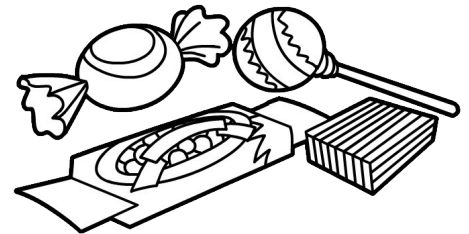
Balance sheet of Shane's shoes

Date: 31 March 2016

Assets		Liabilities	
Current assets	R149 700	Current liabilities	R21 200
Cash	R56 000	Account payable: Bob's polish	R1 200
Stock	R75 000	Account payable: Len's leather	R20 000
Accounts receivable (e.g. debtors owing)	R18 000		
Packaging	R700		
Non-current assets	R363 000	Non-current liabilities	R130 000
Vehicles	R90 000	Notes payable: Mortgage loan	R80 000
Equipment (e.g. cash register, cleaning equipment, shoe brushes, tools, etc.)	R43 000	Notes payable: Vehicle loan	R50 000
Building	R220 000	Total liabilities	R151 200
Furniture (e.g. shelves, desks, chairs, etc.)	R10 000	Owner's equity	R361 500
Total assets	R512 700	Total liabilities + Owners equity	R512 700

Activity 3 - Balance sheet

- Sort the items in the table below into current and non-current assets and liabilities for Rainbow Serve by putting an 'x' in the correct column:



Items	Assets		Liabilities	
	Current	Non-current	Current	Non-current
Cash register: R1 300		x		
Mortgage loan: R242 000				x
Cash in bank account: R85 000	x			
Stock: R105 000	x			
A delivery van: R89 700		x		
Display racks account: R6 680			x	
Debtors owing us money (6 monthly): R32 000	x			
A shop that we owe money to: R12 800			x	
Packaging leftover: R 8 700	x			
Freezer worth: R22 000		x		
Building: R520 000		x		
Furniture: R20 000		x		
Delivery van loan: R33 000				x

- Work out the balance sheet for Rainbow Serve for 31 December 2016 on the following page. You can use a calculator.

Assets		Liabilities	
Current assets	R230 700	Current liabilities	R19 480
Cash	R85 000	Account payable: Display racks	R6 680
Stock	R105 000	Account payable: Furniture	R12 800
Accounts receivable	R32 000		
Packaging	R8 700		
Non-current assets	R653 000	Non-current liabilities	R275 000
Vehicles	R89 700	Notes payable: Mortgage loan	R242 000
Equipment (cash register, freezer)	R23 300	Notes payable: Delivery van loan	R33 000
Building	R520 000	Total liabilities	R294 480
Furniture	R20 000	Owner's equity	R589 220
Total assets	R883 700	Total liabilities + Owner's equity	R883 700

Activity 4 – Personal net worth

1. What are your assets? **Own answer**
2. What are your liabilities? **Own answer**
3. Work out your Owner's equity (net worth) by filling in the balance sheet below (use estimates of what your assets are worth). You can use a calculator.

Balance sheet of _____

Date: _____

Assets		Liabilities	
Current assets		Current liabilities	
Non-current assets		Non-current liabilities	
		Total liabilities	
		Owner's equity	
Total assets		Total liabilities + Owner's equity	

Activity 5 – Case study: Balance sheet of Sally Stevens

/20

Read the case study below and answer the questions that follow:

1. Sally Stevens is in her fourth year of studying a B Com: degree at University. Her parents bought her a flat that costs R1 000 000. The furniture in the flat is worth R85 000. Her study loan over 4 years is R500 000. The interest on this loan is R50 000. Sally has saved R35 000 by working during the holidays. Sally also has a clothing account where she owes R2 500. Her cellphone is worth R6 500, but she still owes R1 200.
 - a) Calculate a balance sheet for Sally for 31 March 2017 using the template on the following page: (18)
(1 mark for each item and amount; 1 mark each for the heading and date)

Assets		Liabilities	
Current assets	R35 000	Current liabilities	R53 700
Cash	R35 000	Interest on loan	R50 000
		Account payable: Clothing	R2 500
		Account payable: Cellphone	R1 200
Non-current assets	R1 091 500	Non-current liabilities	R500 000
Cellphone	R6 500	Student loan	R500 000
Building	R1 000 000	Total liabilities	R553 700
Furniture	R85 000	Owner's equity	R572 800
Total assets	R1 126 500	Total liabilities + Owner's equity	R1 126 500

b) Do you think Sally has a good net worth? Give a reason for your answer. (2)

Yes, she has a net worth of R572 800 (Owner's equity) which is a good value to have if she needs to sell her assets. Her assets are more than her liabilities.

Income and Expenses

Activity 6

- Complete:
 - Income is the money that is **received** by a business for example **sales, goods sold, etc.**
 - An expense is when money is **paid** out by a business for example **salaries, equipment.**
 - The aim of a business is to make a **profit**. Profit = **Income - Expenses**
 - If the expenses are **larger/higher** than the income, then the business will make a loss.
 - Profit is usually calculated on a **year to year basis**.

2. What sort of income are you receiving now?

Own: Pocket money, money for odd jobs done, etc.

3. What sort of expenses do you have now?

Own: Toiletries, movies, entertainment, etc.



Activity 7

1. In pairs, list the types of income and expenses the following businesses will have:

a) A furniture store

Income: Sales, sale of assets e.g. equipment

Expenses: Salaries, drawings, equipment, electricity, water, cost of sales, packaging, furniture, vehicles, uniforms, cleaning supplies, etc.

b) A cosmetic store

Income: Sales, sale of assets e.g. equipment

Expenses: Salaries, drawings, equipment, electricity, water, cost of sales, packaging, furniture, vehicles, etc.

2. Think of a business that you would like to have for Entrepreneur's Day. List the income and expenses that you will have.

Own answer

Activity 8

1. Study the income and expenses for Jacks Shoe Shop for the year and answer the questions that follow.

Item	Income	Expense
Mortgage loan on building: R120 000		R120 000
Electricity: R50 000		R50 000
Delivery trucks: R110 000		R110 000
Furniture for customers: R20 000		R20 000
Salaries: R245 000		R245 000
Shelves bought: R18 000		R18 000
Employees uniforms: R5 600		R5 600
Telephone bill: R17 800		R17 800
Drawings: R60 000		R60 000
Stock sold (Sales): R960 000	R960 000	
Office supplies (stationery): R2 300		R2 300
Cash register: R2 000		R2 000
Cleaning supplies: R3 000		R3 000
Water account: R7 000		R7 000
Shelves sold: R6 000	R6 000	
Shoe stock bought (Cost of sales): R200 000		R200 000
Total:	R966 000	R860 700

- a) Put the amounts in the correct columns, listed 'Income or Expense' above.
b) Calculate the column for the total expenses and income received.
c) Did the shoe shop make a profit or a loss that year? Calculate.

A Profit = Income – expenses

$$= R966\ 000 - R860\ 700$$

$$= R105\ 300$$

- d) Was that a good profit to make for the next year?
Own. Yes, it should cover the expenses for the first few months.
e) If Jacks shoe shop made a loss, what advice would you give the owner?

Cut salary costs, pay for less stock and only buy as needed.

Activity 9: Case study – Frank's Entrepreneur's Day

1. Read the paragraph below and answer the questions that follow:

For Entrepreneur's Day, Frank decides to sell popcorn at R3,00 a packet. Frank makes 100 packets to sell. The popcorn costs R50,00, the oil R15,00, salt and vinegar spice R12,00, zip lock packets R50,00 and the R10,00 rent. Frank pays for the items with his pocket money.

- a) What is Frank's expected income?

$$R100 \times 3 = R300 \text{ expected income}$$

(1)



- b) What are Frank's expenses? (5)
Popcorn, oil, salt and vinegar spice, zip lock packets and rent.
- c) How much did Frank pay for his expenses? (1)
 $R50 + R15 + R12 + R50 + R10 = R137$ paid out
- d) How much profit does Frank expect to make? (2)
 $Profit = Income - expenses = R300 - R137 = R163$ profit expected
- e) Do you think Frank will make a profit? Give a reason for your answer. (1)
Yes, he will receive more income than his expenses combined (own).

Savings and Investments in Business

Activity 10

1. Watch the You tube video: 'Basics of investing – should I save, or should I invest' - and answer the questions that follow:



- a) What should we plan for?
University, asset or retirement.
- b) What can you do with your money?
Look at different investment options.
- c) Why do we put money aside?
To make it grow over time.
- d) What is inflation?
Over time prices increase so we can't buy the same things for the same amount of money.
- e) Do bank's interest rates keep up with inflation over time?
No
- f) What is investing?
Putting money into a financial asset to get a return.
- g) What do you expect from investing in a financial asset?
You expect to generate income and increase value.
- h) What can you do if all goes well with an asset?
Sell it at a higher price than what you paid for it, or keep the asset to earn an income from it for e.g. property.
- i) What do we call the difference between the money that you invest and the amount that you receive?
A return.
- j) According to this video, why is investing better than saving?
It can beat inflation, saving cannot. Greater potential for gains than saving.

Activity 11 - Investing

1. Watch the YouTube video 'Basics of investing' - and answer the questions that follow:



a) Describe Shares or Equity.

If you buy shares, you have a stake in a company, and the right to share in its success. It is an ownership certificate.

b) What happens if the value in a company's shares rises?

The company may decide to make payments to its shareholders called dividends.

c) What happens if losses are made by the company?

No dividends will be paid and share prices drop.

d) What does the share price depend on?

Supply and demand.

e) What influences supply and demand?

The company's profitability, dividends, business prospects or general sentiment of investors and consumers.

f) What is a bond or fixed interest?

A bond is when a person invests in a company and the company pays you interest and then pays you back the borrowed amount.

g) Do bonds ensure a stake in the company?

No

h) Do bonds offer greater price stability than shares?

Yes

i) How is owning land or buildings an investment?

Rental is received by the tenant. Initially this should cover any bond costs and over a period the bond is paid for and the owner retains the capital investment and receives an annuity income.

j) Out of the three options above what would you invest in? Give a reason for your answer.

Shares – you may receive a bigger return and you have a stake in the company. Bonds – you will receive interest and it is less risky than shares.

Land or buildings – can receive rent or sell at a higher price.



Investing your money and risk

Remember that when you put money into an investment it is usually for the long term. You only expect to reap the benefits in two or more years. Long term investments could be for university fees, retirement or starting a business. Investing your money also carries risk, which means that you could potentially lose your money depending on the company that you invest in or if the stock market crashes. On the other hand your investment could give a high return. It is important to do proper research before investing your money.

References

<https://goo.gl/qcPhL5>

<https://goo.gl/Jss2fc>

<https://goo.gl/xObGm>

<https://goo.gl/KdbrJr>

<https://goo.gl/hetS3Y>

<https://goo.gl/AwKBQp>

<https://goo.gl/oFLvvf>

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<https://goo.gl/gSBrK>