REVISION: BUDGETS & ASSETS 20 JUNE 2013

Lesson Description

In this lesson we revise:

- the definition and importance of a Cash Budget
- concepts relating to Value-Added Tax (VAT)
- the concept of fixed assets
- inventory valuation methods

Key Concepts

Cash Budget

A Cash budget is a forecast of the cash position of a business over a future period, setting out expects cash receipts as well as expected cash payments over a certain period of time.

Why is it important to prepare a Cash Budget

- A cash budget is an essential tool used in business to monitor and plan the liquidity of the business enterprise.
- By analysing the Cash Budget, a business is able to see whether there is sufficient cash to meet short-term commitments, purchase stock, purchase additional assets, to pay for business expenses etc.
- In the event of a shortfall of cash, management can make arrangements for an overdraft or make alternate plans.

Expected Receipts vs. Expected Payments

EXPECTED RECEIPTS	EXPECTED PAYMENTS
Cash Sales	Cash Purchase of Stock
Receipts from Debtors	Payments to creditors
Interest received	Payment of operating expenses
Rent Income	Cash drawings
Proceeds from the sale of fixed assets	Cash purchase of fixed Assets
Additional Loans	Repayments of Loans
Fixed deposit maturing	Creating a fixed deposit

Format of a Cash Budget

- Expected Receipts - a forecast of all cash receipts (inflows) for the budget period.

- Expected Payments - a forecast of all cash payments (outflows) for the budget period.

- Cash surplus /(cash shortfall):

  A surplus arises when the expected receipts are greater than payments.

  A shortfall arises when payments are greater than receipts.

Non-Cash Items

- These are items which are excluded from the cash budget as it has no effect on the business cash balance.
- Non-cash items are:
  - Depreciation
  - Trading stock deficit
  - Profit/Loss on sale of asset

VAT

- Remember that VAT is currently 14%!
- Know how to calculate VAT when given the inclusive and exclusive amounts: learn your formulas!
- If you are given the amount excluding VAT:
  - VAT = Amount excluding VAT x 14/100
  - Amount including VAT = Amount excluding VAT x 114/100
- If you are given the amount including VAT:
  - VAT = Amount excluding VAT x 14/114
  - Amount excluding VAT = Amount including VAT x 100/114

Important Theories to Learn

- Zero-rated items vs. VAT-exempt items
- Who must register for VAT? Businesses with a turnover of R____________________ or more
- Receipts vs. Invoice basis of registering for VAT
- The difference between Input and Output VAT
- Tax periods – VAT is paid every two months (<u>bimonthly!)</u>

Remember the Ledger Accounts

- INPUT VAT is an ASSET and represents the VAT we can claim back from SARS on the items we have bought (Debit balance). (ONLY on non-exempt items!)
- INPUT VAT is found in the CPJ, CJ, CAJ and PCJ (dealing with items we have purchased or returned)
- OUTPUT VAT is a LIABILITY and represents the VAT we must pay to SARS on the items we sell (Credit balance).
- OUTPUT VAT is found in the CRJ, DJ and DAJ (dealing with items we have sold or that have been returned to us).
- The business acts as a tax collector for SARS.
- The VAT Control account is a summary of the Input and Output VAT accounts – it is used to calculate the amount that must be paid to SARS or that can be claimed back from SARS.
- Input and Output VAT are closed off to the VAT Control account.
- Learn the format of the VAT ledger accounts carefully!

Fixed Assets

Definition of Fixed Assets

- Non-current assets are broken up into **fixed** and **financial** assets
- Fixed assets – Land and buildings, Vehicles and Equipment
- Financial assets – Fixed deposit (non-current if it has more than a year until maturity)
- Remember that fixed assets depreciate because of wear and tear in daily use and because they become **obsolete** (new products with better technology become available)

Calculating Depreciation

Two methods that are used to calculate depreciation:

On Cost

- Cost x r/100 x n/12 (r = rate, n = no. of months)

Diminishing Balance

- Carrying value x r/100 x n/12

(Remember how to calculate the carrying value!)

Disposal of Fixed Assets

- (This is Grade 11 work) - Very important!
- Learn the format of the asset disposal account!

Format of the Asset Disposal Account

Asset Disposal

Equipment / Vehicles		Accumulated depreciation on vehicles / equipment	
Profit on sale of asset		Bank / Debtors control / Creditors control / Drawings / Donations	
		Loss on sale of asset	

- Make sure you revise your Grade 11 work that teaches you how to complete the Asset Disposal account
- This is often asked as an adjustment in the section on companies – you may need to draw up this account on your own.

Go over note 3 on the balance sheet (Fixed assets)

Inventory Valuation Methods

Important Theory to Learn

- These methods are applied when we want to value our Trading Stock
- It may be challenging to value Trading Stock if prices rise continually (like in our economy!)
- A business can decide on one of several methods (FIFO and weighted average)
- The method chosen should be used consistently throughout the existence of the business (Why?)

Characteristics of FIFO

- Stands for First-In-First-Out
- The stock that was bought first is sold first (oldest stock sold first)
- Closing stock will be valued at the most recent price
- Suitable for any type of business
- Often used by businesses that sell perishable goods
- Shops will display their trading stock in such a way as to encourage customers to purchase the oldest stock first
- Realistic because stock values at the end of the year are calculated at the most recent prices

Characteristics of the Weighted Average Method (WAM)

- Calculate stock value by dividing the total cost of all the merchandise by the number of units in stock
- High prices are averaged with low prices – this means that the gross profit may not reflect current market conditions

Make sure you know how to calculate the following:

- No. of units on hand (closing stock) at the end of the month or year
- Value of the closing stock according to **both** methods
- Value of the cost of sales according to **both** methods
- Value of the gross profit according to **both** methods
- Also ensure that you can comment on your answers and compare the two systems!