Chapter- 6

Business Arithmetic

CASH REGISTER

- Every transaction in business involves cash in one form or the other and all cash transactions are recorded in a book called a cash book or cash register.

➢ IMPORTANCE OF MAINTAINING CASH BOOK

- Without the entries from the Cash Book, no further analysis of expenses, costs, revenues, profit, etc. can be made.
- It helps in the easy computation of cash in hand.

INFLOW

- Owners' Equity: own money invested in the business.
- Loan Received: money borrowed from friends, family, relatives, bank, etc.
- Sales Receipts: money coming in by selling your products or service.
- Interest Earned: money coming in the form of interest on the deposits made in the bank.
- Rent Received: Money coming in by renting outbuilding or room.
- Sale of Assets: Money coming in by selling surplus property like furniture, machinery, old car, etc.
- Claims Received: Money coming in the form of insurance claims like accident claims, fire claims, the maturity of insurance policies, etc.
- Sale of Scrap: Money coming in by selling scrap and waste material, selling rejects, etc.

OUTFLOW

- Land: Purchasing land to start a business.
- Building: Constructing a building or purchasing a building to start a business.
- Plant and Machinery: Investing money in Plant and Machinery to start a business.
- Furniture and Fixtures: Purchasing furniture and fixtures.
- Interior Decoration: Investing money in hiring an interior decorator.
- Tools: Purchasing tools for the business which will be utilized in the business.

- Computers: Purchasing computers.
- Raw Material: Buying of raw materials.
- Packing Material: Money required Employee Benefits: The perks given to employees like travel allowance, medical benefits, etc.
- Incentives: Payment of incentives to employees based on their performance.
- Advertising: Money spent on publicizing the products through the newspaper, television, pamphlets, brochures, public hoardings, etc.
- Rent at Premises: Money being spent on paying the rent for the premises used for the business.
- Sales Commission: Money given to the employees or agents as a commission on sales.
- Interest on Loan: Borrowed money on which interest is to be paid.
- Insurance Premium: Money paid as a premium to the insurance company for covering various risks.
- Travel: Money spent on traveling for the owners and the employees.
- Transportation: Purchasing a vehicle to be used for transporting raw materials, transporting your products to the customer 's premises.
- Salary and Bonus: The money paid to employees.

GENERIC FORMATS OF CASH REGISTER

- Cash register with cash column only
- Cash register with cash and bank columns.

CREDIT TRANSACTION

- Sometimes in business, products are sold on credit which means that the buyer does not pay the money immediately. The buyer will pay at a later date. This is called selling on credit.

➢ Credit transactions can take the following two forms:

- Buying on credit
- Selling on credit
- While credit (whether given or taken) transactions do not get entered in the cash book, the entrepreneur needs to keep track of these and make appropriate entries in the cash

book. To help achieve this, a simple format like the one below would be helpful. It will also ensure that tallying or reconciliation becomes easy.

TYPES OF COST

UNIT SALES

- Unit sales can be defined as the measure of the unit in which the products are sold.
- Unit of sale is a management tool that is required to understand the economies of the business in an easy and standardized way and for tracking progress over some years and taking corrective actions, when necessary.

UNIT COST

- This can be defined as the cost incurred by a company to produce, store, and sell one unit of a particular product or service.
- Units cost is also known as the cost of goods sold.
- Unit cost refers to the variable cost like raw material, packing material, sales commission, freight, etc.

UNIT PRICE

- It is the price at which one unit is sold.
- Many factors influence the price which an entrepreneur fixes for his product, but ultimately, it is the consumer who determines the price, at which the transaction will take place.

GROSS PROFIT

- Excess of unit price over unit cost is known as the unit gross profit or gross profit margin.
- This represents the business's profit from selling a product before deducting overheads or fixed expenses.
- Gross profit per unit = unit price _ unit cost

EXPENDITURE

- It is a payment or disbursement and is equated to the outflow of money.
- Expenditure is the amount spent or liability incurred for acquiring assets, goods, or services.

- EXPENSES ARE FURTHER CATEGORISED AS:
- Capital expenses
- Revenue expenses
- Deferred revenue expenditure

EXPENSE

- An expense is the value of the resource that was used up or was necessary to earn the revenues during the period. For example, the cost of the goods that were sold during the period is considered to be expenses along with other items such as advertising, salaries, interest, commissions, rent, and so on.

COST

- A cost is a derived value of money consumed to produce a current or future outcome; hence, costs provide management a decision-supporting view to improving business economics. Costs are expressed as a value measured in relationship to a causal volume of consumption.

➢ TYPES OF COST:

- **Start-up cost:** Start-up cost is the cost that is incurred initially a business is started. It consists of expenses for (a) acquiring assets as well as (b) for acquiring initial raw material and other related items of initial expenses, till such time the cash flow from the business can provide for these. This part of the Start-up expenses is known as working capital. All these expenses occur from the time you start planning and preparation. Quite often the terms —Start-up and —One time are used interchangeably.
- **Operational Costs**: As the name suggests, are for carrying out the day-to-day operations of the business or enterprise. These can be broadly categorized into Fixed and Variable Costs.
- Fixed cost: these are the ones that an entrepreneur has to incur because one has started a business and is operating it. The fixed costs are not dependent upon the level of output.
- Variable cost: These costs vary with the total cost of the organization when the output varies. Example of raw material, sales commission, etc.

CLASSIFICATION OF A COST AS FIXED OR VARIABLE

- For classifying a particular expense/cost as either fixed or variable, it is important to know for which industry or type of business is it related to. For example:
- The telephone bill is generally a fixed expense, except when it relates to a —Call Center.
- Paper bills in an office or shop would be fixed but in the printing business, it would be variable cost (like raw material).
- Fodder to the cows is variable because more cows mean more milk
- Water in the office is fixed; water in a soft drink factory is variable.
- Stationary in a coaching class is variable because more students mean more but stationary in an office is fixed.
- The most important point to remember is, not to get trapped in classifying an expense in one or the other category, without knowing which business it refers to.

INCOME STATEMENT

- Profit is a financial benefit that is realized when the amount of revenue gained from a business activity exceeds the expenses, costs, and taxes needed to sustain the activity.
- A statement that enables us to determine the profit over some time is known as Profit and Loss Statement or Income Statement. It is also very often known as Statement of Operations.
- This is a statement that shows revenues, expenses, gains, and losses; it does not show cash receipts (money you receive) nor cash disbursements (money you payout).
- The income statement is important because it shows the profitability of a company during the time interval specified in its heading. The period that the statement covers is chosen by the business and will vary.

CASH FLOW PROJECTION

- Cash flow refers to the movement of money in and out of a business during a specific period. It is a record of the company 's inflows and outflows.
- A Cash Flow Projection shows how cash is expected to flow in and out of your business. A Cash Flow Projection will give a much better idea of how much capital investment a business idea needs.

- The historical Cash Flow Statement shows how cash has flowed in and out of a business. In other words, it describes the cash inflow and outflow that has occurred in the past. The Cash Flow Projection shows the cash that is anticipated to be generated or expended over a chosen period in the future.

BREAK-EVEN POINT

- Break-even analysis is an important tool in the hands of entrepreneurs which helps them to assess that volume of business which will help them to recover all their costs.
- A business 's break-even point is the amount or level of sales or revenues that it must generate to equal its expenses. In other words, it is the point at which the company neither makes a profit nor suffers a loss.
- Entrepreneurs can use this information in making a wide range of business decisions, including setting prices, preparing competitive bids, and applying for loans. It also helps in Profit Planning and Goal setting. At the break-even level,
- **Total Revenue= Total Expenses**
- The break-even level is: fixed cost (per month)/ gross margin per unit

TAXES

- A tax is a financial charge or other levy imposed upon a taxpayer by a state or the functional equivalent of a state such that failure to pay is punishable by law. It can also be explained as a fee charged or by a government on a product, income, or activity.
- **Why do Governments levy taxes?**
- The Governments levy and collect taxes to later spend it for social welfare in the form of public expenditure like laying roads, providing social service, paying government workers, and providing other social amenities.

TYPES OF TAXES

- **Direct Tax:**
- A Direct tax is a kind of charge, which is imposed directly on the taxpayer and paid directly to the government by the persons (legal or natural) on whom it is imposed. A direct tax is one that cannot be shifted by the taxpayer to someone else. Direct Taxes are levied directly on income, capital value, wealth, corporate assets.

- **The following are some Direct Taxes:**
- **Income Tax:** Income tax is an annual tax on income (profit). Rates and other details vary based on whether sole proprietor, partnership, or corporation. This is charged on the profit and cannot be included in your costs. That is why we have income before tax and income after tax terms in the income statement.
- Corporation Tax: Corporation tax is a tax levied on the Income (Profit) of the Domestic Company or Foreign Company.
- Property Tax: Property tax or 'house tax' is a local tax on buildings, along with the belonging land, and imposed on owners.
- **Indirect Tax**:
- If tax is levied on the price of a good or service, then it is called an indirect tax, like service tax, sales tax or VAT, central excise tax, customs duty, etc.
- **Some important indirect taxes imposed in India are as under:**
- Customs Duty
- Central Excise Duty
- Service Tax
- Sales Tax or VAT