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# **FINANCIAL ADMINISTRATION**

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## ***Purpose***

To provide the participant with the knowledge, skills and appropriate attitudes to assist management in the preparation, implementation, administration and monitoring of financial plans and budgets.

# **LEARNING OUTCOMES**

## ***Learning Outcome 1***

**Complete simple financial calculations and analyses.**

## ***Assessment Criteria***

- 1.1 Calculate relevant percentages and ratios for financial statements, including;
  - gross profit and net profit percentages;
  - expense percentages;
  - mark-ups and mark-downs;
  - return on investment, current ratio and gearing;
  - ratios to conform with travel agency financial viability tests.
- 1.2 Prepare simple analyses, from the information attained in the 1.1, in relation to the following;
  - liquidity
  - profitability
  - security.

## ***Content***

### **1.1 Analysis of Financial Statements**

Refer to Handout 1.1a “Glossary of Terms” and ask students to tick relevant terms that will be covered in this section.

Provide students with Handout 1.1b “Olympic Travel, explain its contents and its educational purpose for whole subject. Lecturers may prefer to modify this handout to conceal the percentages and ratios for years 2-9 inclusive to allow students an opportunity for practice.

Refer to Year 1 and illustrate and discuss:-

- gross profit and net profit percentages
- expense and productivity percentages

Distribute and explain Handout 1.1c “Travel Australia” referring particularly to:-

- the difference between gross sales (which includes the total value of business written for tickets, accommodation etc that the customer will be paying for) and commission.
- % commission to sales
- cost of goods sold format for souvenir sales
- the concept of contribution
- what a profit & loss statement is
- what a cash flow statement contains and its relationship to cash journals
- what a balance sheet is
- the inclusion of ratios which will be explained later
- the facility and rationale for providing budget figures
- the mechanics and usefulness of comparing actual figures with budgeted figures with the “variation” column
- showing students how to label variations with a “F” for favourable variations and a “U” for unfavourable variations
- show the usefulness of an analysis of variations for composing a profit improvement action plan

Mark-ups and mark-downs.

- refer to Travel Australia to help explain the relationship of GP% to mark-up
- mark-up measures the value of the margin added to the cost of goods purchased (and or manufactured) eg if a souvenir costs \$10 and we added a 50% margin and sell it for \$15, the gross profit is \$5 and GP% 33.3% compared to a mark-up of 50%.
- show students the mental short-cut.....50% = a fraction  $\frac{1}{2}$ , 33.3% a fraction  $\frac{1}{3}$ , the denominator moves up one during the conversion process ie if I add  $\frac{1}{2}$  my gross profit will be  $\frac{1}{3}$
- given a % mark-up on cost, what is the margin? Answer...50 divided by 100 + 50 equals 33.3%. Try this on a calculator.
- given a target % GP margin of 33.3%, what should our mark-up be? Answer.....33.3 divided by 100 - 33.3 equals 50%. Try this on a calculator.
- Refer to Olympic Travel and Travel Australia to explain concisely the following terms, keeping in mind these will be explained in more detail in the next section and more fully in the next level SMTR4.
  - return on investment
  - current ratio
  - gearing

**Ratios to conform with travel agency financial viability tests.**

- Distribute Handout 1.1d “Travel Agents Financial Viability Tests”. These notes are self-explanatory and incorporate illustrations using Travel Australia.

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- Lead students through them, answering questions on the more difficult concepts eg
    - intangibles
    - relationship to normal ratios
    - why “profitability” tests are excluded and how profitability relates to liquidity and security
  - Get students to practice these tests on Olympic Travel

## 1.2 Analysis of Profitability, Liquidity & Security

The three key dimensions of financial management are profitability, liquidity and security.

### Profitability

- is important for measuring the effectiveness of operational management and for providing a flow of funds for the owners to plough back into the business for expansion.
- Refer to Olympic Travel
  - This is a ten year history of sales volume, commission income, expenses and profitability. The expenses are functional headings and so detailed expense items are not provided. to simplify the analysis.
  - Ask how can the Net Profit before Tax for 1991 of \$45 (meaning \$45,000) be assessed as good or bad? Answer theoretically in respect to history, budgets, industry standards, competitors, alternative investments.
  - Return on Investment (ROI)
 

ROI on assets managed compares Net Profit before Tax with Total Assets and is an internal test of managerial efficiency.

ROI on capital compares Net Profit after Tax with owners/shareholders’ funds and is an external test used by outsiders, eg. lenders, prospective shareholders.
  - Discuss balancing risk & return .The higher the risk the higher the return. Ask students what returns they might expect in tourism considering risk, uncertainty and variability if they could earn as an alternative 10% interest with a bank.
  - *Commission Analysis.* Evaluate the importance of each segment as a commission earner and their respective yields.
  - *Expense Analysis.* The functional groups can be related to the income being generated from these expenses as resources.
  - *Marketing Plans.* Discuss theoretically if our marketing plan is working or does it need to be modified?

- *Profit centres.* Discuss the value of evaluating business components in order to better understand the whole. Show how ROI by profit centre is useful.
- *Budgets.* Discuss the value of budgets for comparing with actuals so that variances can be analysed as we saw with Travel Australia and the concepts of management by exception and responsibility accounting.

## Liquidity

- Liquidity refers to having a reasonable float of cash and short term ready access to cash to meet short term commitments. Short term finances have to be managed effectively to preserve liquidity.
- Refer Olympic Travel 1991. Current Assets 192 minus Current Liabilities 114 leaves a difference of 78 for “Working Capital”.
- Current assets were 1.68 times (or 168% of) current liabilities.  

$$\frac{192}{114} = 1.68$$
- Explain that for every \$1 of Current Liabilities we have \$1.68 of Current Assets. The 68 cents is a safety margin or float to avoid liquidation and time-wasting activity struggling to meet short term cash requirements for overheads etc particularly if income falls. Explain that the normal business expectation is current assets to be twice current liabilities.
- Working capital includes cash on hand or in the bank plus other current assets (which we expect will become cash in the short term) minus the short term commitments we have (current liabilities and operating expenses) which we expect will be paid for in cash in the short term, all in the normal course of business and not in a liquidation situation.
- Explain how can we improve working capital ie increase current assets, decrease current liabilities or both.
- Increase current assets by increasing cash at bank with new sources of funds by:
  - reducing fixed assets (selling)
  - .increasing long term liabilities (borrowing)
  - .increasing capital (new capital, profit or both)
- Decrease current liabilities by conversion of debts from short to long term (eg bank overdrafts, shareholders loans)
- Olympic Travel: Assume a ratio of 2 is preferable to 1.68 then our current assets would have to be \$228, an increase of \$36 over the existing level of \$192 using one or several of the sources of funds outlined above. Alternatively (or simultaneously) reduce the \$114 of current liabilities..
- Demonstrate working capital as a tank filled by a pipe at one end with the sources of funds listed above and an outlet at the bottom for uses of working capital.

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- Compare this tank illustration with cash at bank being the reservoir and cash receipts as the inlet pipe and cash payments the outlet. Explain that working capital as a reservoir is similar but we include not just cash but also the excess of short term claims to cash (current assets) over short term commitments to cash (current liabilities).
  - Explain that anything that reduces current assets will reduce the working capital reservoir. The following situations will cause a reduction in current assets through cash flowing out of the bank:
    - increasing fixed assets (buying)
    - decreasing long term liabilities (paying back principal)
    - decreasing capital (returning capital, losses, or both).
  - Explain the need for strong internal control over cash, debtors and creditors.

### Security

- Long term finances have to be managed effectively to preserve the long term financial structure of the business. Security refers to having a reasonable foundation on which to build this financial structure.
- Long term finance is of two kinds:-
  - long term liabilities ( borrowing's from outsiders )
  - capital ( funds supplied indefinitely by the owners of the business including accumulated profit).
- Security refers to the relationship between long term liabilities and capital. The higher the former the less secure the financial foundation of the business.
- Long term liabilities are attractive because we can borrow to finance investments which hopefully will provide for improved profitability. But they place a burden on the business with definite commitments for interest and principal repayments.
- Discuss how corporate high fliers can get into trouble by not being able to re-finance their borrowing's and then having to suffer a forced sale of their assets (and perhaps liquidation) to repay lenders.
- Discuss the factors determining the mix of long and short term funds. As a general rule we should never borrow long and invest short and that if we want to invest in long term fixed assets we should never borrow short, rather finance these investments with long term borrowing's.
- Discuss the alternative uses of long term finance.
  - to replenish working capital (increase current assets and/or reduce current liabilities). This is not normally recommended because we should not borrow long to invest short. It is done in a crisis with a view to restoring profitability so that (hopefully) future profit can generate the necessary funds to

repay the loan or to attract new borrowers or shareholders for replacing the loan funds.

- for investment in fixed assets
  - for replacing other long term borrowing
  - to finance a return of capital.
- In Olympic Travel the figures concerning long term debt capacity for 1993 are as follows:

Long Term Loan	50
Capital	<u>199</u>
Total Long Term Funds	249

- In percentage terms the long term loan (debt) is 20% of long term funds. Normally however we relate long term loans not to total funds, but to capital. The answer then is .25 (or 25%).
- Therefore 50 compared with 199 is .25 or 25%. We have then to decide whether a ratio of .25 is good or bad. As a general rule we like to see a ratio of .5 .
- Debt-equity ratios are often referred to as “gearing” or “leverage” ratios. Businesses are highly geared if their long term debt is far greater than their capital base and conversely of being lowly geared when it is only a fraction of the capital base.

## ***Learning Outcome 2***

**Describe the usefulness of the computer in financial management for maintaining simple computer-based bookkeeping records and cash budgets.**

### ***Assessment Criteria***

- 2.1 Analyse the nature and operation of an accounting computer package, taking into account the following factors;
  - the features of at least one accounting sales brochure;
  - the advantages for multi-users and on-line enquiries;
  - provisions for budgeted as well as actual inputs.
- 2.2 Describe the use of spreadsheets in relation to the following factors;
  - financial calculations;
  - price list preparation;
  - inventory listing;
  - budget worksheets.
- 2.3 Prepare a spreadsheet version of a manually prepared cash payment and cash receipts journal.
- 2.4 Prepare a simple monthly cash budget, include the following;
  - cash outflow and inflow entries for profit & loss statement and balance sheet items;
  - net cashflows and carry forward bank balances;
  - actual cash movements incorporated from spreadsheet journals;

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- variations between actual and budgeted cash flows;
  - explanation of the difference between cash flow and profit & loss statements.
- 2.5 Describe the application and manipulation of spreadsheets in relation to budgeted financial statements, include the following:
- assumptions related to key operating variables;
  - profit and loss budget;
  - cash flow budget;
  - balance sheet budget;
  - percentage and ratio calculations;
  - funds statements.

## ***Content***

### **2.1 Computerised Accounting**

- this section involves hand-on familiarisation with a computer accounting program. Learning providers will need to have the necessary class-room hardware and software facilities and to provide student access to manuals.
- the recommended software is “Sybiz Elite 2” which is a TAFE standard product although other packages may be used
- refer to Handout 2.1a “Sybiz Reference Guide” which has been prepared by the author (not Sybiz) to assist lecturers navigate their way through the manuals in preparation for delivery and answering student questions
- students should be encouraged to make their own dealer enquiries and collect and compare a range of brochures
- discuss the advantages of an on-line up to date system compared with a periodic accounting system for assessing current financial position and profitability and for on-line operational enquiries
- explain the idea of integration and simultaneous posting to various ledgers
- explain multi-user operations using networking
- demonstrate an overview using the sample accounts provided with the software including
  - standard chart of accounts
  - changing ledgers
  - establishing, editing and viewing ledger accounts
  - sales and purchase invoicing
  - cash payments, cash receipts, deposits and bank reconciliations
  - trial balances for general, debtors and creditors
  - accounting and management reports
  - utility routines
  - password access
  - back-up routines
- distribute the following Handouts in reference to “Destination Theatres” (used previously by learners in GSM19 Tourism Accounting for manual cash and accrual accounting procedures).
  - Handout 2.1b - Transaction Summary
  - Handout 2.1c - Standard Chart of Accounts



- Handout 2.1d - Cash Book
- Handout 2.1e - Sales & purchases journal
- Handout 2.1f - Bank Statement & Bank Reconciliation Statement
- Handout 2.1g - Profit & Loss Statement, P&L Appropriation Statement
- Handout 2.1h - Balance Sheet
- using these Handouts for “Destination Theatres”
  - set up a new ledger “Destination Theatres”
  - modify the chart of accounts
  - have students enter the cash and credit transactions from the transaction summary into the general ledger and print a trial balance, profit & loss statement and balance sheet
- demonstrate how a budget prepared on a spread-sheet could be imported and show how this would appear on the management reports
- demonstrate how ledger information could be exported (eg debtors, inventory)

## 2.1 **Spread-sheets - general purposes**

- financial calculations
  - ensure students have had basic training on a spread-sheet package
  - have students re-create some selected sections from Travel Australia and Olympic Travel to practice
    - additions (inc. down-adding & cross-adding) and subtractions
    - multiplication and division
    - percentages and ratios
    - mark-ups, gross profit and contribution
    - calculating break-even points
- price-list preparation
  - prepare and print a hypothetical price-list for Travel Australia souvenirs (say 5 items) with columns for product number, product group code, description, cost price, mark-up 150%, retail \$ mark-up, sales tax @ 21% of cost, retail price (inc tax), retail price (exc tax), gross profit, gross profit% (using ex tax retail price), 30% wholesale discount for groups, discount \$ (discount % x retail inc tax price), wholesale price
  - sort in product group code order and print
- inventory listing
  - copy columns product number, product group code, description and cost price to a new spread sheet
  - add columns for supplier, bin number, re-order point
  - sort in bin number order for stock-take purposes and print
- budget work sheets
  - prepare a template on disk of Column 1 text from pages 1&2 of Travel Australia and provide copies to students
  - have students prepare a single column for a full budget year ending 30/6/96 using Handout 1.1c as a guide and assumptions you set for sales, gross profit and expenses

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### 2.1 **Spread-sheets - journals**

- use Destination Theatres handouts from GSM 19
- have students re-create the cash payments and cash receipts journal with an extra column for account number after the bank column
- have students create formulae for each money column to the right of the new column

### 2.2 **Spread-sheet - cash flows**

- use Handout 1.1c Travel Australia “Cash Flow” as a guide
  - have students create 3 columns for budget, actual and variation for each of 3 months July, August and September.
  - enter only cash inflow items, variable costs, 5 overheads, 2 assets and 1 liability (loan principal)
  - split the July/Aug figures shown over the 2 months July and August for these items
  - apply appropriate formulae to calculate progressive balances
  - add estimates for September
- discuss the difference between cash flow statements and profit & loss statements, referring to accruals and prepayments, balance sheet items and cash movements with creditors and debtors

### 2.3 **Spread-sheet financial budgets**

- issue students with a disk and Handout 2.5 for Travel Australia budgeting.
- students to copy file to new filename
- explain carefully
  - the structure, logic and formulae approach of the spread-sheet
  - assumptions related to key operating variables;
  - profit and loss budget;
  - cash flow budget;
  - balance sheet budget;
  - percentage and ratio calculations;
  - funds statements.
- ask students to prepare a new column for a new budget year and enter new figures in cells without formulae. Make sure they balance.
- ask students to prepare in class a new blank spread-sheet with only the following items from Handout 2.5.
  - two assumptions (depreciation rate and direct labour %)
  - two income items (one cash sale, one credit sale)
  - three costs (depreciation, salary with accrual, insurance with a prepayment and direct labour)
  - no cost of goods sold, stock or contribution
  - capital as an inflow
  - one asset purchase

## ***Learning Outcome 3***

**Describe the links between business plans, marketing plans, financial plans and budgets.**

## ***Assessment Criteria***

- 3.1 Describe the purpose and content of at least one business plan, giving particular attention to the following factors:
- quantification of objectives and targets;
  - adequacy of external data used to establish industry and best practice benchmarks;
  - process used in its formation and implementation;
  - provisions for establishing accountability.
- 3.2 Describe the purpose and content of at least one marketing plan, giving particular attention to the following factors:
- links with a profit and loss budget and balance sheet, particularly items such as product, price, promotion and distribution;
  - alternative areas for improving the net outcomes by 10%.
- 3.3 Justify the income, cost and asset lines from a specified set of financial budgets, by reference to supporting business plan and/or marketing plan documentation or other rationale.

## ***Content***

- 3.1 Describe the purpose and content of at least one business plan**
- distribute case study “Village Restaurant” (Handout 3.1)
  - discuss the structure and content of Vic Talbot’s report
  - discuss the normal components of a business plan in simple terms
    - internal and external situation analysis (SWOT)
    - mission, objectives and strategies
    - resource allocation and budgeting
  - relate these components to the normal problem solving process
    - situation appreciation
    - assessment of underlying needs and issues
    - problem / opportunity definition
    - definition and evaluation of alternatives
    - choice and implementation

ask students questions concerning how well the business planning process was followed by Vic Talbot particularly in reference to the following factors:

- quantification of objectives and targets;
  - adequacy of external data used to establish industry and best practice benchmarks;
  - process used in its formation and implementation;
  - provisions for establishing accountability.
- ask students how they would approach the financial management consulting task having in mind the business planning and problem-solving steps outlined above

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### 3.1 Describe the purpose and content of at least one marketing plan

- describe in very simple terms the normal components of a marketing plan
  - market research (consumers, competitors, industry trends etc)
  - marketing mix (product, price, promotion, distribution)
  - objectives, strategies, implementation
- ask students which parts of Vic Talbot's report relate to a marketing plan
- briefly compare the components of business plans and marketing plans
- demonstrate the links between a marketing plan and financial statements (actual and budgeted profit and loss statements and balance sheets) particularly items such as product, price, promotion and distribution)
  - price reflected in sales revenue
  - product as income (influencing demand) and cost (of product research and development)
  - promotion having an income effect on sales and a cost effect on selling costs
  - distribution which transfers promotion costs into lower selling prices to intermediaries for potential income gains through higher sales volume
  - demand for funds arising out of the marketing plan including working capital to finance the build up in stocks and debtors and for fixed assets (new equipment and long-term product development costs)
  - supply of funds through increased liabilities and possibly the disposal of unwanted fixed assets
  - expectations for liquidity, profitability and security
- ask students what alternative areas might there be for improving the net outcomes of Village Restaurant by 10%. Highlight the value of a financial management approach to profit improvement
  - increase sales volume
  - increase price
  - change product mix
  - decrease quantities and prices for bought-in items and other direct costs
  - change marketing expenditure
  - reduce other overheads
  - reduce assets employed

### 3.2 Justify the income, cost and asset lines from a specified set of financial budgets, by reference to supporting business plan and/or marketing plan documentation or other rationale.

- distribute the solution the Village Restaurant (Handout 3.3)
- lead students through the spread-sheet analyses (ignore the more complex ratio analysis which will be dealt with in a later subject SMTR 4)
- lead students through the "Outline Solution" and stress
  - the value of always starting with the financial statements in case analysis (and real life)

- the need for a preliminary budget exercise to size up the issues and to provide a sensitivity model for later analysis as the business and marketing plan progresses
- the value of computer generated reports for owners and lenders
- the need for a plan and a budget with harmony between them including
  - objective, well-researched and defensible planning justification for each budget line
  - quantifying the relationship between human resource implementation (organisation design, recruitment, job re-design, program and project planning etc) and budget line items

### ***Learning Outcome 4***

**Prepare a set of simple budgets for one year for a selected small tourism business.**

### ***Assessment Criteria***

- 4.1 Prepare a sales budget by month, including the following factors:
  - total sales;
  - type of product;
  - type of customer;
  - top 10 customers and remainder;
  - by geographic area;
  - underlying assumptions;
  - links to market research, segmentation and targeting;
  - budget responsiveness to changes in underlying assumptions.
- 4.2 Prepare and explain a simple cost budget, including the following factors:
  - variable costs;
  - fixed costs.
- 4.3 Prepare and explain a simple cash budget, including the following factors;
  - cash outflow items for costs, assets, and reductions in liabilities;
  - cash inflow items for income, liabilities and reduction of assets;
  - calculate net cash flows and forward monthly bank balances;
  - allowances for sales, purchases and expenses on credit.

### ***Content***

The exercise “Outback Hotel” will be used. This should have been distributed and marked earlier as Assignment 2. Part 2 of this exercise (see paragraph 2 “Student’s Brief - Computer Exercise” in the assignment handout) will now be done in class (but not assessed). Learners might also find Handout 4.1 useful (balance sheet history for “Outback Hotel”).

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The computer model to be set up as a class exercise will be similar to Travel Australia and lecturers might allow that model to be used as a base. The steps to be followed by students include:-

**4.1 Sales budget**

- establish 13 columns for the 1983 budget (12 monthly columns and a total year column)
- design a set of revenue assumptions as a front-end to the model
  - with quantity and average price lines for each of 10 key travel operators and other corporate clients (cattle stations and/or mining company clients)
  - a quantity and price line for “sundry sales”
- include an extension line (quantity times price) in the profit and loss section of the model with each line to be given a geographic and product code for sorting purposes (avoid multi-location coding)
- discuss the possible links of these figures to market research, segmentation and targeting;
- discuss the likely responsiveness of your model to allow for changes in underlying assumptions.

**4.2 Cost budget**

- establish several cost assumptions for variable costs
- complete the variable costs and fixed costs
- show contribution and net profit
- complete the profit and loss model to include taxation and profit & loss appropriation ( see Village Restaurant model)

**4.3 Cash budget**

- prepare a simple cash budget for the 12 months including the following factors:
  - cash outflow items for costs, assets, and reductions in liabilities
  - cash inflow items for income, liabilities and reduction of assets
  - calculate net cash flows and forward monthly bank balances
  - allowances for sales, purchases and expenses on credit
- explain the nature and purpose of the cash flow statement

***Learning Outcome 5***

**Prepare a set of complex budgets for a large tourism business.**

***Assessment Criteria***

**5.1 Prepare on a computer, a budget model reflecting:**

- operating variables;
- cash flow;
- profit & loss;
- balance sheet;
- ratios and funds statement.

- 5.2 Describe how key ratios for liquidity, profitability and security are calculated and can vary with changes to operating variables.
- 5.3 Describe how management can assess operational effectiveness through use of complex budget data.

### ***Content***

A large tourism business will be formed by Olympic Travel taking over Travel Australia as at 1/7/96. Travel Australia has been struggling recently but offers considerable scope for expansion to Olympic with its more effective management and financial resources.

#### **5.1 Computer budget model for the merged operation :**

- use the Olympic Travel model as a base
- in the merged operation the souvenir lines will be discontinued and the stock sold for cash during July 1996 as “Sundry”.
- set up a 1995 column for the combined profit & loss and balance sheet figures
- assume that Travel Australia’s 1995 air business to be split in the same proportion as Olympic’s by type of customer
- Travel Australia’s tour business is to remain as a separate line
- complete yearly budgets for the next 5 years (1996-2000 inclusive) for
  - cash flow
  - profit & loss (including taxation and appropriation components)
  - balance sheet
  - ratios
  - funds statement (use the approach followed by Village Restaurant)
- introduce new assumptions and amounts for taxation and dividends
- print out the new model

#### **5.1 Ratios for liquidity, profitability and security**

- discuss how they have been calculated in the model
- copy the model to a new file-name for sensitivity analysis purposes
- formulate and trial various action plans for improving the ratios eg.
  - to improve liquidity increase profitability, sell fixed assets
  - to reduce liquidity increase long-term investment in securities or fixed assets, pay off long-term debt, increase dividends and/or return capital
  - to improve profitability increase income, increase margins, reduce costs or reduce funds employed
  - to improve security increase capital or reduce long-term debt
- remember the ratios should be in harmony. An integrated plan is required.

#### **5.1 Describe how management can assess operational effectiveness through use of complex budget data.**

- discuss the relationship of sensitivity modelling to business and marketing planning

- 
- discuss how the model might
    - interface with a computer accounting system
    - be used as a management reporting system by including actual accounting figures and variations to budget



## ASSIGNMENT

### 1

#### ACADEMIC TRAVEL

NOTE:

This assignment relates to learning outcome 1.

This assignment under examination conditions should be completed in 2 hours.

A Travel Compensation Fund test schedule is provided below.

The financial objectives are:-

- ROI 15% after tax
- Current Ratio 2.0
- Gearing 0.5.

#### QUESTION:

Using the financial objectives above and the Travel Compensation Fund requirements set out below as a guide, analyse the existing financial performance of Academic Travel Pty Ltd and suggest ways for improving the financial situation.

#### TRAVEL COMPENSATION FUND

Capital and Reserves

##### Turnover

##### Minimum Capital & Reserves

Less than \$750,000	\$10,000
\$750,000 to \$1.5 million	\$20,000
Greater than \$1.5 million	\$35,000

Test 1: Client Travel Account: (Maximum 4 points)

Test 2: Working Capital available to meet overheads

Greater than 2 months	8 points
1-2 months	5 points
Less than 1 month	2 points
No working capital	0 points

Test 3: Net tangible asset to turnover ratio

Greater than 3%	8 points
1.5% to 3%	5 points
Less than 1.5%	2 points
No tangible assets	3 points

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**ACADEMIC TRAVEL PTY LTD****FINANCIAL INFORMATION****1. PROFIT & LOSS STATEMENT (for year ended 30.6.91)**

Commission		\$ 1,472,000
<b>Less Expenses</b>		
Accountancy	\$ 13,400	
Advertising	214,200	
Bank Charges	6,600	
Depreciation	10,400	
Electricity	3,200	
Insurance	4,000	
Interest	15,200	
Motor Vehicle Running Costs	12,000	
Motor Vehicle Fixed Costs	16,000	
Printing	115,000	
Rent	132,000	
Staff Expenses	1,600	
Telephone	18,800	
Travel	133,200	
Wages (inc. owners)	492,400	
Other Expenses	<u>229,000</u>	<u>\$ 1,417,000</u>
		\$ 55,000
<b>Plus Other Revenue</b>		<u>5,000</u>
<b>NET PROFIT (Before Tax)</b>		\$ 60,000
<b>INCOME TAX</b>		<u>\$ 27,000</u>
<b>NET PROFIT (After Tax)</b>		<u>\$ 33,000</u>

**NOTE:**

1. Commission was earned on a sales turnover figure of \$17,500,000.
2. \$2,500,000 of this turnover was considered to be unprofitable.

**2. CAPITAL STRUCTURE (as at 30.6.91)**

Debtors	\$ 230,000
Short-term Borrowing's	60,000
Capital at commencement	300,000
Undistributed Profits (retained earnings)	18,000
Creditors	200,000
Cash at Bank- General Account	160,000
Office Equipment	70,000
Fixtures & Fittings	50,000
Formation Costs	8,000
Goodwill	80,000
Long-term Borrowing's	150,000
Deposits from Customers in Client Ledger	82,000
Land and Buildings	
130,000	
Cash at Bank - Client Travel Account	82,000

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### Alternative balance sheet

#### Current Assets

Debtors	230,000	
Cash - General	160,000	
Cash - Client Travel A/c	82,000	472,000

#### Fixed Assets

Office Equipment	70,000	
Furniture & Fittings	50,000	
Land & Buildings	130,000	250,000

#### Intangible Assets

Formation Costs	8,000	
Goodwill	80,000	88,000

Total Assets		810,000
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#### Current Liabilities

Deposits from Customers	82,000	
Short term borrowing's	60,000	
Creditors	200,000	342,000

#### Long Term Liabilities

Long term borrowing's	150,000	
150,000		

#### Capital

Capital at beginning	300,000	
Retained earnings	18,000	318,000

Total Liabilities		810,000
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## ASSIGNMENT 2

### OUTBACK HOTEL

#### 1. STUDENT'S BRIEF

- 1.1 Accommodation and Catering** (25 marks)
- 1.1.1 Fill in the figures in the spaces marked with an asterisk (\*). (5 marks)
- 1.1.2 Set up a 1993 budget column on the following assumptions:-
- weekly average turnover \$3,200
  - food cost 13% of sales
  - wages 17% of sales
  - all other expenses rounded up to next \$00
- eg. \$276 becomes \$300  
\$3,102 becomes \$3,200 (5 marks)
- 1.1.3 Assume all expenses remain constant at the 1992 level, what would net profit be if both room occupancy and tariffs were increased by 10% and how? (5 marks)
- 1.1.4 What is meant by a "cost of goods sold" format? Illustrate how this might have been done for 1992. (5 marks)
- 1.1.5 Briefly describe the accounting treatment of "depreciation" and "buildings". How would you explain the reduction of \$63,000 in "buildings" in 1991? (5 marks)
- 1.2 Bar Trading and Liquor Shop** (20 marks)
- 1.2.1 Fill in the figures in the spaces marked with an asterisk (\*). (5 marks)
- 1.2.2 Set up a 1993 budget column on the following assumptions:-
- weekly average turnover \$5,300
  - closing stock \$9,000
  - wages 15% of sales
  - all other expenses rounded up to next \$00
- eg. \$276 becomes \$300  
\$3,102 becomes \$3,200
- 1.2.3 Calculate an amended 1992 Net Profit assuming:-
- both opening and closing stocks were underestimated by \$1,000
  - wages 13% of sales
  - doubtful debts \$1,000. (5 marks)
- 1.2.4 Illustrate a "contribution" format for the 1983 budget and briefly explain the advantages of same. (5 marks)
- 1.3 Financial Summary** (30 marks)
- 1.3.1 Assuming that the land cost of \$40,000 is evenly split between the two profit centres, how would you compare the profit results? (5 marks)
- 1.3.2 A prospective purchaser desires a 40% return on assets (excluding goodwill); how might this be achieved? (5 marks)
- 1.3.3 Explain in layman's terms how the \$56,000 goodwill was arrived at and what it means. (5 marks)
- 1.3.4 How would you apportion goodwill between the profit centres and would this be of any advantage? (5 marks)
- 1.3.5 What further information would you require to complete a detailed financial ratio analysis? Would you recommend this extra analysis and if so, why? (10 marks)
- 1.4 Feasibility Analysis - Accommodation & Catering** (25 marks)
- 1.4.1 Make some assumptions and do some figurework to suggest what a budget for 1994 might be on the basis of:-
- the proposal to refurbish 10 rooms;
  - your existing 1993 budget. (5 marks)

- 
- 1.4.2 Describe the alternative methods for financing the refurbishing proposal. (5 marks)
- 1.4.3 There is a new large site next door which is coming onto the market soon. You see an opportunity for a new motel under “Outback Hotel” management. Without figurework describe in general terms how you would approach this kind of feasibility study and the likely contents of your report. (15 marks)

## **2. STUDENT’S BRIEF - COMPUTER EXERCISE**

This is not part of the assignment and will be undertaken as a separate learning exercise after the assignment has been marked and returned. The computer model to be followed will be similar to Travel Australia and lecturers might allow that model to be used as a base. The steps to be followed by students include:-

### **2.1 Sales budget**

- establish 13 columns for the 1983 budget (12 monthly columns and a total year column)
- design a set of revenue assumptions as a front-end to the model
  - with quantity and average price lines for each of 10 key travel operators and other corporate clients (cattle stations and/or mining company clients)
  - a quantity and price line for “sundry sales”
- include an extension line (quantity times price) in the profit and loss section of the model with each line to be given a geographic and product code for sorting purposes (avoid multi-location coding)
- discuss the possible links of these figures to market research, segmentation and targeting;
- discuss the likely responsiveness of your model to allow for changes in underlying assumptions.

### **2.2 Cost budget**

- establish several cost assumptions for variable costs
- complete the variable costs and fixed costs
- show contribution and net profit
- complete the profit and loss model to include taxation and profit & loss appropriation ( see Village Restaurant model)

### **2.3 Cash budget**

- prepare a simple cash budget for the 12 months including the following factors:
  - cash outflow items for costs, assets, and reductions in liabilities
  - cash inflow items for income, liabilities and reduction of assets
  - calculate net cash flows and forward monthly bank balances
  - allowances for sales, purchases and expenses on credit
- explain the nature and purpose of the cash flow statement

## **3. CASE STUDY DETAILS**

### **Site**

The hotel is located on a corner site in the centre of town. There is good street parking and the intersections are two main roads beading in to Dundee Springs. Two blocks, Lots 69 and 70, 49sq.m. and Lot 70, 1012sq.m. sloping to the rear right of way falling 3.1 metres.

### **District**

Dundee Springs has a town population of 1,200 and a Shire population of 3,800. A small shopping complex of five shops has just been completed and is occupied. The residential building rate has increased by 30 per cent in the past two years as new services are established, farmers retire and other farmers prefer being in the town and 'commuting' to the farm.

Farming practice has changed from grazing to cropping safflower and rape-seed which has a ready market at coastal plants less than 100km away. Tourism is also good as the hotel is on the Alligator River which has good scenic qualities.

### **Buildings**

The original building is sixty-four years old and now houses the room accommodation, manager's flat, bathrooms, guest lounge, linen room, office and entrance hall. It has been renovated and well-maintained. The new addition (1972) houses the lounge, bars and kitchen. This is brick and in very good condition. Motel block 'A' level 1 in brick with asbestos roof needs some repairs and painting. Block 'B' is only thirteen years old and is in excellent condition. The conversion of eight rooms into motel units was completed in January.

### **Potential**

The only liquor licenses are the Outback Club and Wally's General Store with a Store Licence.

The town is growing and tourism is increasing particularly following a major feature film shot in this location. It will be necessary to add more motel units and perhaps provide a large entertainment area in the hotel to cope with this growth. Population size would preclude attempts to establish a second hotel or tavern licence for some considerable time.

### **Valuation Assessment**

The land is a prime location and is zoned an hotel site and is licensed by the Court.

	Accom- Total modation and catering	Bar and liquor shop	Trade
<b>Assets</b>			
Land as commercial site			40,000
Hotel section		80,000	80,000
Hotel "A" block	85,000		85,000
Hotel "B" block		68,000	68,000
Laundry & garages		15,000	15,000
Plant & furnishings	16,100	41,900	58,000
Estimated stock	1,500	9,000	<u>10,500</u>

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<b>Total Assets</b>			356,500
Average net profit	55,084	47,757	102,841

**Goodwill**

Current earning rate 14% of 356,500	49,910
Reasonable proprietor's salary	<u>39,000</u>
	88,910
Average net profit for three years	102,841
Less proprietor's salary and earning rate of assets	<u>88,910</u>
	<u>13,931</u>

Goodwill is \$13,931 times a factor of 4 or \$56,000

**ASSESSED VALUE**

Land as commercial site	40,000
Premium for special zoning	20,000
Premium for licence	45,000
Buildings	248,000
Plant and furnishings	58,000
Goodwill	<u>56,000</u>
Assessed value less stock	\$ 467,000



## **Bar Trading & Liquor Shop**

### **Plant & Equipment**

Most of the dispensing equipment and refrigeration shown in the inventory is modern, good quality and well-maintained. Lounge furniture could be replaced. The plant and furnishings are assessed at \$41,900.

### **Stock**

Inspection of the stock (approximately \$9,000) indicates good control. There are very few slow-moving lines, but there are good stocks of packaged beer. Rail delivery is twice a week so there is no need for a high inventory in this department. In 1991, refrigerated bars were installed in the lounge bar which adjoins the public bar with an open door partition and the lounge was totally carpeted together with the dining room, entrance hall and the hall leading to the room accommodation. Electronic spirit measures were installed in march and a soft drink bulk dispenser, all of which appear warranted as the lounge bar trade is increasing significantly. The new layout of the bars allows one barmaid to serve both bars in slack periods, eliminating one casual.

The coolroom was new in 1991 and is 5 metres by 3 metres and has ten display doors facing the public bar and the packaged liquor server at the far end of the public bar. The well planned layout of the bars, lounge and entertainment area gives the lounge bar adequate facilities to cater for 140 in the lounge.

Brewery returns show an average turnover of 15 kilderkins and 1.9 "tens" per week. Packaged beer accounted for \$48,280 of the total liquor purchases of \$127,251. On present trends the lounge will have to be extended another 8 metres to cater for the increasing trade. Wages of \$41,000 appear to be high, but the district provides a number of services and functions which attract up to 200 people to each function: pig sales, stud sheep sales; clearing sales and horse auctions.

Although they are spread throughout the year, there are no set days and casual labour must be "on tap" and hired at premium rates.

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**Outback Hotel**  
**Accommodation & Catering**  
**Profit & Loss Account**

	<b>1990</b>	<b>1991</b>	<b>1992</b>
Sales	110,640	*	159,620
<i>Less Financial Expenses</i>			
Borrowing Expenses (new motel units)	-	-	975
Bank Charges	87	176	224
Interest	2,014	1,460	*
Sub-Total	*	1,636	17,481
<i>Selling Expenses</i>			
Advertising	973	1,060	2,555
Commission	640	471	566
Sub-Total	1,613	1,531	3,121
<i>Administration Expenses</i>			
Accounting Fees	300	300	470
Cleaning	820	970	1,390
Depreciation	3,630	3,740	2,536
Electricity & Telephone	2,480	2,911	3,695
Fuel & Gas (h.w.s.)	1,976	2,240	2,828
Insurance	647	723	723
Magazines, Journals etc.	181	193	274
Maintenance of Aquarium	48	48	56
Motor Vehicle Expenses	946	1,180	1,457
Permits, Licences & Fees	580	580	666
Printing & Stationery	220	310	465
Rates & Taxes	1,064	1,064	1,493
Repairs & Maintenance	610	1,024	6,637
Replacement Linen & Cutlery	330	480	1,176
Subscriptions	26	12	8
Wages	18,641	*	28,795
Food purchases	<u>17,963</u>	<u>18,610</u>	*
Sub-Total	*	<u>58,835</u>	*
<b><u>Total Expenses</u></b>	<u>54,176</u>	<u>62,002</u>	*
Net Profit	*	<u>43,838</u>	<u>64,949</u>

### Business Facts - Accommodation and Catering

Weekly average Turnover	*	*	*
Inventory turnover ratio (food)	*	*	*
Occupancy rate rooms	88.00%	87.00%	80.00%
% Food cost to sales	%*	%*	%*
Net profit/Assets ratio	%*	%*	%*
Net profit/Sales ratio	%*	%*	%*
Turnover ratio	*	*	*
Wages % to Sales	%*	%*	%*

Total Assets calculated at:

Furnishings	18,600	15,600	14,000
Food	2,100	2,000	1,500
Plant	5,400	6,500	*
Buildings	168,000	106,000	*
	194,100	129,100	*

Additions & alterations were made in May 1981

New laundry equipment in June 1981

New motel units in January 1982

Tariff: Single rooms	1 night	\$ 8,00
Double rooms	1 night	\$14.00
Motel Unit Single	1 night	\$20.00
Motel Unit Double	1 night	\$25.50
Motel Unit Family (4 beds)	1 night	\$30.00

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## OUTBACK HOTEL Bar Trading & Liquor Shop Profit and Loss

	1990	1991	1992
Trading (sales)			
Beer, wines & spirits	219,941	231,810	245,283
Cigarettes & sundries	*	<u>32,440</u>	<u>29,283</u>
	<u>256,352</u>	*	<u>274,566</u>
Opening Stock	8,860	8,610	*
Purchases	115,690	*	127,251
Less Closing Stock	*	<u>9,500</u>	*
Sub-Total	<u>115,940</u>	<u>124,097</u>	<u>127,769</u>
Gross Profit	*	*	<u>146,797</u>
Financial Expenses			
Borrowing Expenses	1,046	873	473
Bank Charges	620	1,043	392
Interest	<u>12,480</u>	<u>13,611</u>	<u>11,801</u>
Sub-Total	<u>14,146</u>	<u>15,527</u>	*
Selling Expenses			
Advertising	815	940	1,064
Entertainment	8,460	11,080	*
Commissions	<u>186</u>	<u>443</u>	<u>812</u>
Sub-Total	<u>9,461</u>	*	<u>14,516</u>
Administration Expenses			
Accounting Fees	910	1,140	1,140
Legal Fees	240	873	290
Cleaning	1,986	2,700	2,640
Electricity	4,105	5,360	5,816
LP Gas (H.W.)	683	690	720
Insurance	1,186	1,186	1,340
Motor Vehicle Expenses	1,087	2,432	1,100
Permits & Licences	102	164	150
Liquor Tax	7,967	8,770	9,146
Repairs & Maintenance	3,140	2,994	4,616
Printing & Stationery	420	346	140
Replacement Bar Utensils	1,010	416	364
Wages	38,420	39,600	*
Freight	<u>2,760</u>	*	<u>3,122</u>
Sub-Total	*	<u>69,711</u>	<u>71,584</u>
<b>Total Expenses</b>	<u>87,623</u>	<u>97,701</u>	*
Net Profit	*	*	*

**BUSINESS FACTS - Bar Trade & Liquor Shop**

Weekly average turnover	*	*	*
Inventory turnover ratio	*	*	*
Brewery returns-Kilderkins per wk	12	14	15
Brewery returns-'Tens' per wk	2.3	2.8	1.9
Average Markup ratio	%*	%*	%*
Gross Profit %	*	*	*
Net profit/Assets ratio	%*	%*	%*
Net profit/Sales ratio	%*	%*	%*
Turnover ratio	*	*	*
Total assets	*	*	*
	85,000	128,000	123,000

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# GLOSSARY OF TERMS

# HANDOUT 1.1A

**Account**

An accounting record that shows increases and decreases relating to an item on a balance sheet or income statement.

**Accounting**

Bookkeeping and accounting work to prepare financial statements for a business. A measurement and record keeping process to facilitate planning, decision-making and control. Includes preparation of journals and ledgers.

**Accounts Payable**

Amounts payable to suppliers for goods or services provided. Alternatively called "creditors".

**Accounts Receivable**

Amounts owed to the business by customers for goods or services provided. Alternatively called "debtors".

**Accrual Accounting**

Accounting based on the period during which income was earned or costs incurred irrespective of when cash changes hands for these items. Based on the idea of matching costs and revenue for a period of time.

**Adjusting Entries**

Entries made at the end of an accounting period to record necessary changes in the general journal.

**Administrative Expenses**

Costs incurred to provide management with goods and services to allow office functions to be performed.

**Aged Debtors Listing**

A list of debts indicating amounts owed by debtors over set periods of time, eg. current, 30 days, 60 days, 90 days and over, etc. Alternatively called a "debtors trial balance."

**Amortization**

Periodic charges to income for the cost of improvements or intangibles having a limited life.

**Assets**

Resources owned by an individual or a business that are used to generate sales activity.

**Balance Sheet**

A financial statement prepared at a particular date reflecting the financial position of the business. It shows assets (things owned) and liabilities (things owed).

**Bank Account**

A depository for cash funds. Cash receipts are deposited in the account and are withdrawn by cheque.

**Bank Reconciliation**

The act of bringing the cash balance on the books in line with the balance shown on the bank statement.

**Bank Statement**

A monthly statement of account prepared by the bank which shows deposits received and cheques cleared as at a given date.

**Break-even Point**

The point at which zero profit is made. That is, where the surplus of income over variable costs (called contribution) equals fixed costs.

**Capital**

Amounts invested in a business by its owners, partners or proprietor as a basis for operations. Sometimes called "shareholders' funds", "equity" or "proprietorship".

**Cash**

Includes monies in cheque or savings accounts as well as petty cash. Sometimes referred to as "cash at bank".

**Cash Accounting**

Accounting method in which income is recognized when payment is received and expenses charged when paid.

**Cash Payments Journal**

A book of original entry used to record transactions made by cheque.

**Cash Receipts Journal**

Book of original entry which records funds received.

**Chart of Accounts**

A list of account titles used by a business.

**Closing Entries**

Journal entries prepared at the end of a fiscal period which close out revenue, cost of sales and expense accounts.

**Contribution**

The surplus of sales revenue over variable costs. An amount available to meet fixed costs and profit.

**Cost**

Amount spent or liability incurred for goods or services. Alternatively called "expenses." Includes variable and fixed costs.

**Cost of Sales (Cost of Goods Sold)**

In a tourism business this includes amounts spent to pay for services of suppliers such as airlines, tour operators, car rental companies, charter operators or hotels, etc. In other businesses, includes amounts spent on goods for re-sale or for services provided.

**Credit**

Right side of an account page. We credit increases in income (revenue), increases in liabilities, decreases in costs (expenses) and decreases in assets.

**Creditors**

Amounts payable to carriers and suppliers for services rendered. Alternatively called "accounts payable".

**Creditors Ledger**

Used to keep track of every financial event affecting a creditor (invoices, payments, returns, etc.). Makes use of a Control account which is a mirror image of the creditors account in the general ledger. Used for reconciling with statements provided by creditors.

**Current Assets**

Resources owned by the business including cash and other resources that can be converted into cash in the short term (usually within 12 months). Normally includes cash, debtors, short term investments, stock, pre-payments.

**Current Liabilities**

Resources owed by the business including bank overdraft and other items that must be paid for in cash within the short term (usually within 12 months). Normally includes bank overdraft, creditors, accrued expenses, provision for dividend, provision for tax. For a travel agency deposits from customers are included.

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**Debit**

Left side of an account page. We debit increases in costs (expenses), increases in assets, decreases in income (revenue) and decreases in liabilities.

**Debtors**

Amounts owed to the business by customers for services rendered (or goods sold). Alternatively called "accounts receivable".

**Deposits from Customers**

Funds received by a travel agency in advance of a tour or cruise and reflected as a current liability since services are usually to be provided in less than one year.

**Depreciation**

Allocation of the original costs of a fixed asset over its estimated life to reflect obsolescence, wear and tear. A book entry and is not a funds item. It relates to the purchase of a fixed asset some time in the past. The only impact on funds is when that asset was originally purchased.

**Double-entry System**

Bookkeeping system in which at least two accounts are involved in every transaction ie. every transaction has two perspective's. By making two entries out of one event we set up a system for double-checking our recording, guarding against fraud, inaccuracy and carelessness, etc.'

**Equity**

Amounts invested in a business by its owners, partners or proprietor as a basis for operations. Sometimes called "capital", "shareholders' funds" or "proprietorship".

**Expenses**

Amounts expended while offering services to customers to earn income. Alternatively called "costs". Includes variable and fixed costs.

**Financial Management**

Planning and controlling the flows of financial resources to ensure that a business achieves profitable growth with appropriate liquidity and security.

**Financial Statements**

Statements prepared at the end of an accounting period, such as the balance sheet, the income statement and the funds statement.

**Fixed Assets**

Assets which were purchased for long term purposes for producing income. Not intended to be converted into cash within 12 months and therefore referred to as long term assets or capital expenditure.

**Fixed Cost**

An expense or cost that tends to be relatively fixed in the short run (say 12 months).

**Funds Statement**

A statement prepared at the end of an accounting period showing the sources of funds and the application (or uses) of funds. Basically it reflects the changes in Balance Sheet items between two balance dates.



**Gearing**

Related to security and leverage. Business are highly geared when their long term debt is far greater than their capital base and conversely lowly geared when it is only a fraction of the capital base.

**General Ledger**

Contains accounts and is posted from journals. It summarises information under special headings for the following classifications: income, costs, assets, liabilities and is balanced regularly.

**Goodwill**

The amounts of money a purchaser pays for a business over and above the value of resources being purchased. It represents a premium for the intangible assets associated with the location of the business, its reputation and its logos and name, etc.

**Gross Margin**

The excess of sales revenue over cost of sales where cost of sales includes the cost of raw materials and other costs involved in manufacturing. Sometimes referred to as "gross profit". Cost of sales is sometimes referred to as "cost of goods sold".

**Gross Sales**

*see Sales*

**Horizontal Analysis**

Measurement of changes in corresponding items in successive financial statements.

**Income Statement**

A summary of the financial results of operations under the headings of income and expenses for a period of time highlighting net profit. Alternatively called a "profit and loss statement."

**Interest Expense**

Amount of interest paid on instalment loan payments, bank loans, mortgages, etc.

**Interest Income**

Amount earned on savings accounts or certificates of deposit.

**Journals**

Record events from source documents summarising periodic cash movements (payments & receipts) and periodic credit movements (purchases & sales). Used for posting to ledger. A general journal is used to record other special events like provision for doubtful debts and re-allocations and corrections.

**Leasehold Improvements**

Expenditure associated with improving a rented property for use during a lease period. Classified as a fixed asset and carried out with the landlord's permission.

**Liabilities**

Amounts owed by a business for funds supplied on a short term or long term basis. Includes current liabilities, long term liabilities and capital.

**Liquidity**

Concerns access by a business to an adequate level of short term finance to meet short term financial needs. Related to working capital.

**Long Term Finance**

Long term finance is of two kinds, long term liabilities and capital. The former represents borrowing's from outsiders whilst the latter represents funds supplied indefinitely by the owners of the business and includes profit that has been accumulated. Related to long-term liabilities.

**Long Term Liabilities**

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Amounts owing to outsiders for funds provided not due to be repaid within the short term, say 12 months. Sometimes called "deferred liabilities". Includes long term mortgages and debentures. Related to long-term finance.

**Marketable Securities**

Investments which can be converted into cash easily, such as certificates of deposit issued by banks and savings and loan associations.

**Market Value**

The price at which an asset can be currently purchased or sold.

**Net Loss**

Excess of costs (expenses) over revenues (income).

**Net Profit (Net Profit)**

The excess of income over expenses as shown by a profit and loss statement for a period of time.

**Net Worth**

The difference between total assets and the sum of current liabilities and long-term liabilities. Corresponds to capital.

**Note**

Written promise to pay a certain sum of money at a fixed time.

**Notes Payable**

Claims by creditors of the company, evidenced by a promissory note.

**Notes Receivable**

Claims against debtors of the company evidenced by a note.

**Occupancy Expenses**

Costs incurred to provide a business with a place to do business, eg. rent, lighting, etc.

**Original Cost**

Cost at which an asset was purchased.

**Outstanding Cheques**

Cheques issued by the company which have not cleared the bank at the end of the month when the bank statement is issued.

**Overhead Expenses**

Costs of operating the business.

**Partnership**

A business enterprise conducted by two or more persons in which a written or oral agreement is made.

**Pay Back Period**

The number of years of net cash flow required to equal the initial investment. Expressed in number of years.

**Personnel Expenses**

Expenditures made on behalf of employees for wages, salaries, fringe benefits, payroll taxes, etc.

**Petty Cash**

Special cash fund for handling small payments.

**Posting**

Process whereby the transactions recorded in the journals are transferred to the ledger accounts.

**Pre-payments**

Amounts paid in advance in respect to costs for future periods or by customers in anticipation of services to be rendered, eg. for a travel agency, pre-paid tour expenses are amounts paid to the agency by clients prior to their departure date.

**Present Value**

The value of a dollar earned in the future in today's terms.

**Profitability**

Concerns the capacity of a business to provide owners and investors with an adequate return on their investment after satisfying the financial needs of customers, suppliers, employees and taxing authorities.

**Profit & Loss Appropriation**

Net profit earned in the past which owners have decided shall remain in the business for use in future operations. The amount "ploughed back" into the business to help finance future growth. The amount left over after income tax and dividends have been deducted from net profit from operations. Alternatively referred to as "retained earnings" or "accumulated profit".

**Profit & Loss Statement**

(Alternatively called an "Income Statement or Revenue Statement") measures the profitability for a firm over a period of time by simply comparing income (revenue) and expenses (costs).

**Proprietorship**

Amounts invested in a business by its owners, partners or proprietor as a basis for operations. Alternatively called "shareholders' funds", "equity" or "capital".

**Ratios**

Relationships between financial figures expressed as multiples or percentages to simplify comparisons between accounting periods and with other businesses. They enable comparisons to be made despite great differences in the numbers involved.

**Ratio Analysis**

Ratio comparisons to help us form opinions as to whether business performance is "good" or "bad" or "better" or "worse" than previous performance and/or competitors.

**Refunds**

Cheques issued for the cancellation of a sale after payment has been received.

**Retained Earnings**

Net profit earned in the past which owners have decided shall remain in the business for use in future operations. The amount "ploughed back" into the business to help finance future growth. The amount left over after income tax and dividends have been deducted from net profit from operations. Alternatively called "profit & loss appropriation" or "accumulated profit".

**Return on Investment (ROI)**

A ratio which compares the return for a business (net profit) with the amount of investment in the business (assets or equity). There are two measures most often used. The first is ROI on assets managed. This compares net profit before tax with total assets and is a popular "internal" test of managerial efficiency. The second is ROI on capital. This compares net profit after tax with owners/shareholders' funds and is a test most often used by outsiders, eg. lenders, prospective shareholders. ROI is a function not only of earning power (as indicated by the Profit & Loss Statement) but also of asset turnover (of which Stock and Debtors are a part).

**Revenues**

Income from the sale of goods and services and includes commissions earned from sale of airline tickets, charters, tours, hotel reservations or car rental reservations.

**Sales**

*see "Revenues"*

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**Sales Journal**

A book of original entry used to record sales.

**Security**

Refers to having a reasonable foundation on which to build the financial structure of the business. Security refers to the relationship between long term liabilities and capital. The higher the former the less secure the financial foundation of the business. Related to security and leverage.

**Shares**

Units showing ownership of a corporation.

**Shareholders' Funds**

Amounts invested in a business by its owners, partners or proprietor as a basis for operations. Alternatively called "capital", "equity" or "proprietorship".

**Trial Balance**

Lists all the account balances for a ledger as at a given date. Used for creditors, debtors, general ledgers and sometimes for stock (inventory). Proof of accounting accuracy.

**Variable Cost**

An expense or cost that tends to vary directly in proportion to the volume of business activity.

**Vertical Analysis**

Measurement of the relationship among the items on a single financial statement.

**Working Capital**

The difference between current assets and current liabilities. The amount of liquid capital to meet short term commitments. It represents a comfort zone or cushion to meet the demands of our current liabilities and operating expenses as they occur. It represents cash plus other current assets (which we expect will become cash in the short term) minus the short term commitments we have (current liabilities and operating expenses) which we expect will be paid for in cash in the short term.

**Work Sheet**

A form used to assist in the preparation of financial statements.

## **CASE STUDY - OLYMPIC TRAVEL**

Olympic Tours is a fictitious travel agency operating in Australia.

The case study includes ten years of financial history beginning in 1991 with the commencement of business operations (see attached).

### **1991**

- Mr & Mrs Greenway started their business with \$200,000 capital in 1991.
- A five-year lease was arranged with an option to renew for a further five years.
- Alterations and improvements were carried out assuming the owner would repay them after 5 years..
- Two full-time sales personnel were immediately employed to help Mr Greenway who managed the business whilst his wife worked part-time in administration and accounting.
- A short-term overdraft was arranged with the bank.

### **1992**

- The Greenways decided some adjoining land for future expansion partly as a sign to the landlord (as a negotiating ploy) that they had other options and were not dependent on renewing the lease.
- The business began to be affected by a downturn in the economy. This took the Greenways by surprise since they had not anticipated such a marked downturn in their original business plan and budgets.
- Because of this downturn, pressure on liquidity intensified. Fearing the worst, and to allow for possible future expansion, the Greenways contributed another \$50,000 in capital for the business.
- Another salesperson was employed to service corporate accounts.

### **1993**

- The economy started to improve and the Greenways decided the time was right to launch a new advertising programme. This included a direct mail programme. A marketing plan was discussed but owing to pressure of business was not completed.
- The liability to the bank increased to a point where a long-term loan had to be negotiated and to this end Mr Greenway had his accountant prepare a three-year profit and cash flow budget which the bank had requested. Fortunately the accountant participated in the application for loan discussions and so Mr Greenway was not called on to answer tricky questions about liquidity and profitability.
- Another salesperson was employed.

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## **1994**

- A motor vehicle, to be used for entertaining senior commercial account managers was purchased. It was resolved by the board also that in future all new vehicles and office equipment would be leased rather than purchased.
- A sales incentive scheme was initiated, rewarding sales staff for budget achievement. This was geared not only to sales volume, but also to commissions earned, new business won, and to staff productivity.

## **1995**

- Another salesperson was employed with the promise of a full-management position in the short to medium term.
- Advertising was increased to stimulate the touring and cruise markets. A small sum was also spent on market research.

## **1996**

- The lease on the premises was renewed for another five years and the landlord offered to reimburse the Greenways for all improvements that had been made. Mr Greenway thought that it would be a good idea at some point in time to get his lawyer to formalise this arrangement.
- The investment in land was liquidated on the basis that this new long-term lease had been finalised.
- A full time accountant was employed to take over the work that Mrs Greenway had been doing, (who retired from active participation in the business) together with assistance from an outside firm of accountants.
- Some short-term investments were made as an attempt to save for possible future acquisition of another travel agency and/or for retirement.
- Another three sales positions were made possible by continued growth.

## **1997**

- The amount of short and long-term debt was considered to be too high and the Greenways decided to set aside funds for retirement of this debt.
- The advertising budget was further expanded in an attempt to increase commission yields.

## **1998**

- Another two salespersons were employed and also a part- time clerk to assist the accountant.

## **1999**

- Additional funds were spent on direct selling for subsidiary activities to counter the effect of a major airlines squeeze on commissions.
- Salaries for sales staff were comprehensively reviewed and increased to help establish an industry leadership position.
- A block of land was purchased in an adjoining area to allow for future expansion.
- Increases in Council rates (passed on by the landlord) were not budgeted and were due to escalating property values.
- The Greenways decided that there was a need for good business planning to cover the next five years primarily because of fears of firstly, a possible severe downturn in the

overseas travel market, secondly, an adverse movement in the Australian exchange rate and thirdly, a possible severe slump in the property market.

## **2000**

- Another two full-time salespersons were employed in the domestic travel sector making a total of six full-time selling personnel, together with Mr Greenway as Manager, who was devoting 60% of his time to servicing clients and other marketing matters.
- There was a possibility that several agencies would become available for sale and there also appeared to be several prospective buyers for Olympic Travel. All of these options were to be evaluated along with an overall assessment of business performance over the last 10 years and future prospects.