ACCOUNTING TVET LEVEL II TTLM

Develop Understanding of Taxation

LO.1. Identify and discuss the role of taxation in the Ethiopian economy
LO.2. Identify and discuss direct tax
LO.3. Identify and discuss indirect tax
LO.4. Identify and discuss stamp duty tax
LO.5. Manage tax liability

LO.1. Identify and discuss the role of taxation in the Ethiopian economy

1.1. The purpose of taxation in the Ethiopian economy is explored and discussed

The purpose of taxation may include:

- Raising revenue for the government
- Removal of inequalities in income and wealth
- Reduction in regional imbalances
- Ensuring economic stability
- Creation of employment opportunities
- Preventing harmful consumption
- Encouragement of exports
- To support the functions of the government

1.2. The various ways that tax is collected and from whom is analyzed and discussed

Ways that tax is collected include:

1. **Direct tax** – if both the impact and incidence fall on the same person(employees tax)

   Direct taxes include:

   - Tax on employment income/personal income tax
   - Business profit tax
   - Property tax/income from rental of buildings
   - Tax on interest income on deposits
   - Dividend income tax
   - Tax on income from royalties

Royalty – a sum of money paid to a patentee for the use of a patent or to an author or composer for each copy of a book sold. A payment made by a producer of minerals, oil, or natural gas to the owner.

   - Tax on gain of transfer of certain investment property
   - Tax on income from games of chances
   - Agricultural income tax
   - Land use tax

2. **Indirect tax** – the impact and incidence fall on different persons. The tax is not borne by the person on whom it is levied and can be passed on to others.

Indirect taxes include:

- **Turnover tax** – is levied by the government on the sales which are not covered under VAT (value added tax).
- **Value Added Tax (VAT)** – is levied by the government on the commodities sold at specified percentage (15%) on the value of sales.
- **Excise duty** – are levied on the commodities produced in the country.

- **Customs duty** – includes both import and export duties. These duties are levied when the goods cross the boundaries of the country.
- **Stamp duty tax** – a duty levied on the legal recognition of certain documents.

1.3. **The role of the Ethiopian Revenue and Customs Authority (ERCA) is identified and discussed**.

The authority shall have the roles to:

- Establish and implement modern tax assessment and collection system
- Provide quality and efficient service within the sector
- Properly enforce incentives of tax exemptions given to investors and ensure that such incentives are used for the intended purposes
- Implement awareness creation programs to promote a culture of voluntary compliance of taxpayers in the discharge of their tax obligations.
- Carry out valuation of goods for the purpose of tax assessment and determine and collect the taxes
- Conduct study and research to improve the enforcement of custom and tax laws and regulations; and implement the same upon approval
- Collect and analyze information necessary for the control of import and export goods and the assessment and determination of taxes
- Compile statistical data on criminal offences relating to the sector and disseminate the information to others as may be necessary

1.4. What taxation revenue is used for is explained and related to the well-being and lifestyle of Ethiopian citizens

Taxation revenue may be used to provide:

- Defense and boarder protection
- Education
- Environment protection
- Essential infrastructures such as:
  - Roads
  - Transport systems
  - Public buildings
  - Sport and recreation
  - Public housing
- Health care
- Justice systems
- Public safety
- Scientific and other research

LO.2. Identify and discuss direct tax

2.1. Key terminology used in direct taxation is identified and discussed

Terminology used in taxation may include:

- Interest on deposits
- Allowances
- Deductions such as:
  - Travel expense
  - Medical cost
  - Transportation allowance

- Hardship allowance
- Depreciation expense
- Commission expense
- Promotion expense
- Cost of sales
- Insurance expense
- Interest on loan

- **Exempt threshold** – income level free from tax
- **Capital gain/appreciation** - gain of transfer of certain investment property
- **Dividends** – distribution of profits by corporate bodies to shareholders/owners
- **Gross income** – the total of all income received by a tax payer before exemptions deductions.
- **Tax evasion** – tax concealment (hide, cheating)
- **Withholding tax** – a tax required to be withhold(saved, secured, held)
- **Taxable income** – is the residual (remained) amount of income after all allowable deductions are made from gross income.

2.2. Rates of direct tax are identified and analyzed

Direct taxes include:

- Personal income tax
- Business profit tax
- property tax
- dividend tax
- capital gain tax

Tax rate for personal income tax:

Income level	Tax rate	deductions
0 - 600	0 %	0
601 -1,650	10 %	60
1,651 -3,200	15 %	142.50
3,201 – 5,250	20 %	302.50
5,251 – 7,800	25 %	565
7,801 – 10,900	30 %	955
>10,900	35 %	1,500

E.g. **Abraham** earns a gross salary of Br. 3,145. Calculate the income tax.

Income tax = gross salary * tax rate - deduction

= 3,145 *15% - 142.50

= **329.25**

E.g.2. Ato Tola gets salary of Br. 8,000 per month. He also gets hardship allowance and transportation allowance of Br. 800 and 500 respectively. He has worked an overtime of Br. 1,000 during the month. During the month he felt sick and hospitalized and the employer paid him medical bills amounting to Br. 600.

Required:

1. gross income
2. taxable income

3. tax amount

Solutions:

Gross income = basic salary + transportation allowance + medical cost + overtime + hardship allowance

= 8,000 + 500 + 600 + 1,000 + 800

= **10,900**

Taxable income = Gross income – deductions

= Gross income – trans. Allowance – medical cost – hardship allowance

= 10,900 – 500 – 600 – 800

= **9,000**

Tax amount = Taxable income * tax rate – deduction

= 9,000 * 30% - 955

= **1,745**

Business profit tax

It is a tax imposed on the taxable business income realized from a business activity.

Corporate businesses are required to pay 30% flat rate of business income tax and 10% (on the dividend amount) dividend tax if a business declares a dividend.

Corporate businesses include:

- **Private limited company** – is a company whose members are liable only to the extent of their contributions. A private limited company shall not have less than two or more than fifty members and is always commercial in any form. The capital of a private limited company shall not be less than 15,000 Br.
- **Share company -** is a company whose capital is fixed and divided into shares and whose liabilities are met only by the assets of the company and the members shall be liable only to the extent of their shares holdings. The capital shall not be less than 50,000 Br. A company may not be established by less than five members.

Deductible expenses:

- the direct cost of manufacturing, purchasing, and importations
- general and administrative expenses
- promotion expense
- premiums payable on insurance
- commission expense
- interest on loan
- depreciation expense

Profit and loss statement

A profit and loss statement helps to determine whether a business is operating at a profit or a loss for a given time period.

Five basic steps to calculate the profit and loss statement:

1. **sales** – including sales for cash or credit
2. **Cost of sales** – the price paid by the business for merchandise sold.
3. **Gross profit** – calculated by **subtracting** the **costs of sales from sales.**
4. **Expenses** – this include labor costs and other costs of operating the business.
5. **Net profit before tax** – is the amount remaining when the expenses are deducted from the gross profit.

6. **Net profit after tax** – the amount remaining when the tax amount to be paid is deducted from the net income /net profit before tax.

Illustration

ABC P.L.C manufacturing company imported raw material by birr 900, 00 and additional purchase local materials for birr 500, 00 before Vat for production of X product. The company is charged local customs duty of birr 50, 00 and paid to tax authority. The company sales were 4,000 products at birr 650 each before Vat, including 2% sales commission. Total administration *expenses of the company show birr 460,000* and **withhold birr 15,000 of employment income tax.**

Required

1. Calculate net profit
2. Calculate direct and indirect tax

Solutions

Sales= sales including/0.2
Sales=4000*650/0.2
Sales=***52000***
Cost of sale =900, 00+500, 00+50, 00
Cost of sale=**1, 450, 00**
Expenses = Administration expense= **460, 00**

Required 1.

HD manufacturing company
Income statement
For the year ended of 2019

Sale ----------52000
Cost of sales---------- **1, 450, 00**
Gross profit ----------50550
Administrative expenses---------- (460, 00)
Net income ----------**50090**
Business tax (30% of **net income**) ----------15027
Net profit ----------**35063**

Required 2,

Direct tax =**Business profit tax + employment income tax**
=**15027**+**15,000**
=**30027**

Indirect tax

Output VAT = 15 %(***52000)***
= **7800**
Input VAT = 15 %(500, 00)
=**75,000**
Net Vat = output VAT-input VAT
= **78,000**-75,000
= **3000**
Indirect tax = Net VAT + Customs duty
= 3000 + 75,000
= **78.0000**

For unincorporated or individual businesses, the income tax ranges from 10% - 35%. Unincorporated business includes:

- sole proprietorship – a business owned by a single owner
- partnership - a business formed by an agreement of two or more persons

Unincorporated or individual businesses are taxed in accordance with the following schedule:

Income(per year)	Business income	Deductions
0 -7,200	0%	0
7,201 – 19,800	10%	720
19,801 – 38,400	15%	1,710
38,401 – 63,000	20%	3,630
63,001 – 93,600	25%	6,780
93,601 – 130,800	30%	11,460
>130,800	35%	18,000

E.g. MY enterprise, unincorporated business has reported a taxable income of Br. 60,000 of the tax year ending Sene 30, 2019.

Required: Determine the amount of business income tax.

Solution:

Tax = taxable income * tax rate – deduction

= 60,000 * 20% - 3,630

= **12000**

Rental income tax

Rental income tax is a tax imposed on the income from rental of buildings.

Tax rate

The tax payable on rented houses shall be charged, levied and collected at the following rates:

a) On income of bodies (P.L.C and S.C) thirty percent (30%) of taxable income.
b) On income of persons according to the following schedule.

Income (per year)	Business income tax rate	Deductions
0 -7,200	0 %	0
7,201 – 19,800	10 %	720
19,801 – 38,400	15 %	1,710
38,401 – 63,000	20 %	3,630
63,001 – 93,600	25 %	6,780
93,601–130,800	30 %	11,460
>130,800	35 %	18,000

c) Sub-renting shall pay the tax on the difference between income from sub-renting and the rent paid to the renter.

d) The following amounts shall be deducted from income in computing taxable income
   - Taxes paid with respect to the land and buildings being rented, except income taxes
   - For tax payers not maintaining books of accounts, fifty percent (50%) of the gross income received as rent for buildings furniture as an allowance for repairs, maintenance and depreciation of such buildings, furniture and equipment.
   - For tax payers maintaining books of account, the expenses incurred in earning, securing and maintaining rental income, to the extent that the expense can be proven by the taxpayer; deductible expenses include ***the cost of rent of land, repairs, maintenance, and depreciation of buildings, furniture and equipment as well as interest on bank loans, insurance premiums, land use fees.***

Illustration

W/ro Muluwork the owner of AZ building constructed at Br. 5,000,000 and furnished with furniture and equipment, which costs Br. 500,000.She, rented it to Omega primary school for Br. 50,000 per month for one year.

Required:

- Calculate Gross income
- Taxable income
- And rental income tax

Solution

From W/ro Muluwork

Gross income = 50,000 (monthly rent income) * 12

= **600,000**

Taxable income = gross income - rent expense

= 600,000 – 540,000

= **60,000**

Rental income tax = Taxable rental income * tax rate – deductions

= 60,000 * 20% - 3,630

= **8,370**

Other income taxes

A. **Royalties** (5%).
B. **Tax on income from games** (15%)
C. **Tax on dividend** (10%).
D. **Tax on interest income of deposits** (5%). In any other case, 10% of the gross amount of the interest.
E. **Capital gains tax (tax on gain at transfer of certain investment property)**

Income tax shall be payable on gains obtained from the transfer (sale or gift) of property at the following rates:

I. Building held for business, factory office 15% (fifteen percent)
II. Share of companies 30% (thirty percent)

F. **Income from casual rentals**

asset in Ethiopia (including any land, building, or movable asset) shall be liable for income tax at the rate of 15%.

2.3. How direct tax is assessed, ***tax returns*** completed and paid is considered and discussed

Tax returns can be completed by:

- accountant

- an individual
- tax agent
- on-line or in written form

2.4. ***Sources of ongoing information*** about direct tax in Ethiopia are identified, accessed and discussed

Sources of ongoing information may include:

- accountants and other financial services professionals
- Ethiopian Revenues and Customs Authority (ERCA)
- Industry associations and professional organizations
- Federal and Regional governments agencies
- Taxpayers

LO.3. Identify and discuss indirect tax

3.1. Key terminology used in indirect taxation is identified and discussed

1. **Turnover tax** – is levied by the government on the sales which are not covered under VAT (value added tax).

The base of computation of the turnover tax is the gross receipts in respect of goods supplied or services rendered.

Tax rate

- 2% (two percent) on goods sold locally for services rendered locally
    a) 2% on contractors, grain mills, tractors and combine-harvesters
    b) 10% on others

2. **Value Added Tax (VAT)** – is levied by the government on the commodities sold at specified percentage (15%) on the value of sales.

The following are some of the terms that are common in VAT.

- **Input VAT** – the VAT that your business pays over on taxable supplies made (VAT paid on purchase) and can be recovered only insofar as your business is VAT-registered.
- **Output VAT** – the VAT that your business collects over taxable supplies (VAT paid on sales)
- **VAT payable** – this is the net VAT to be paid to ERCA by a taxable person.
  VAT payable = output VAT – INPUT vat

  Output VAT is **VAT** which you must calculate and collect when you sell goods and services, provided that you are registered in the **VAT** Register. ... **Input VAT** is **VAT** which is included in the price when you purchase vat able goods or services for your business.

- **VAT refundable** – the net VAT that is a taxable person expected from **Ethiopian revenues and customs authority** (ERCA) when input VAT exceeds (greater than) output VAT.
- **Zero-rating** – the supply is charged with VAT at 0% but credit can be taken for VAT paid on purchases used to make supply.

- **Exemptions** – the supply is exempted from VAT. No VAT is charged on supply and no credit can be taken for VAT paid on purchases used to make the supply.

3. **Excise duty** – are levied on the commodities produced in the country.

The base of computation of excise tax is the ***cost of production*** for goods produced locally; whereas for goods imported the base of computation would be the ***cost of importation, insurance and freight cost*** (CIF).

The excise tax rate range from 10% to textile and textile products to 100% for other alcohol drinks, perfume and motor vehicles above 1800 c.c.

E.g. KK textile factory produced 1,500 tons of printed bed sheet in meskerem1, 2009. The unit cost of production for a ton of printed bed sheet is as follows:

Direct labor	Br. 4000
Raw material	5,500
Cost of indirect inputs	1,500
Overhead costs	500

Required:

a) Unit base of excise tax (unit cost of production per ton for tax purpose)
b) Total amount of excise tax

Total unit cost = direct labor + raw material + cost of indirect inputs + overhead costs
= 4,000 + 5,500 + 1,500 + 500
= **11,500**
Total production cost = tons of bed sheet produced * total unit cost
= 1,500 * 11,500
= **17,250,000**
Excise tax payable = total cost of production * tax rate
= 17,250,000 * 10%
= **1,725,000**

4. **Customs duty** – includes both import and export duties. These duties are levied when the goods cross the boundaries of the country.

3.2. The ***structure of business*** and how this affects taxation are analyzed and discussed

The structure of business includes:

sole trader: an individual trading on their own

partnership: an association of people or entities carrying on a business together, but not as a company

Private limited company – is a company whose members are liable only to the extent of their contributions. A private limited company shall not have less than two or more than fifty members and is always commercial in any form. The capital of a private limited company shall not be less than 15,000 Br.

trust: an entity that holds property or income for the benefit of others

company: a legal a legal entity separates from its shareholders

3.3. How indirect ***tax is assessed*** and paid is considered and discussed
Tax is assessed through:

- Business Activity Statements
- payroll
- allowable deductions
- capital gains
- financial adjustments such as:

  - write-offs
  - revaluations
  - profits and losses
  - superannuation payments
  - fringe benefits assessment

3.4. Sources of ongoing information about indirect tax in Ethiopia are identified, accessed and discussed

LO.4. Identify and discuss stamp duty tax

4.1. Key terminology used in stamp duty taxation is identified and discussed
4.2. How stamp duty tax is assessed and paid is considered and discussed
4.3. Sources of ongoing information about stamp duty tax in Ethiopia are identified, accessed and discussed

LO.5. Manage tax liability

5.1. How ***tax payers can determine their tax liability*** is identified and discussed
Tax payers can determine their tax liability by:

- assessing income:

  - capital gains
  - employment
  - foreign
  - investment
  - rental property income

- assessing deductions:

  - allowable medical expenses and health insurance rebates
  - capital losses
  - gifts and donations
  - rental property expenses
  - tax offsets
  - work related clothing expenses
  - work related education expenses
  - work related travel expenses
  - zone and overseas forces allowances

- lodging returns and paying governments:

- land tax where applicable
- payroll tax (rate varies by jurisdiction and depends on size of payroll so many small business operators are exempt)
- stamp duty on:
  - ✓hire purchase agreements
  - ✓insurance polices
  - ✓leases and mortgages
  - ✓motor vehicle purchases
  - ✓property transfer

5.2. ***Under or overpayment of tax*** and its implications are analyzed and discussed
Under or overpayment of tax may involve:

- claiming interest on early payments that may be possible for certain tax categories such as:

  - income tax
  - Higher Education Contribution Scheme
  - amended assessments of earlier years
  - paying interest on overdue amounts

Module Title: Develop and Use a Personal Budget

LO1. Analyze and discuss budgeting as a financial tool
LO2. Develop a personal budget
LO3. Implement and monitor the personal budget
LO 1.ANALYZE AND DISCUSS BUDGETING

1.1 The Role Of Budgeting In The Lives Of Different Groups
WHAT IS BUDGET (BUDGETING?) 1,,definition.doc
WHAT IS BUDGET/ BUDGETING???...2,,definition .

- **A budget is a formal estimate of future revenues & costs**
- **Budgeting is a critical step in business planning**
- **It puts ideas into numbers for profit or loss measurement**
- **Budgets arPe valuable tools in good management**

- A budget is a quantitative plan used as a tool for deciding which activities will be chosen for a future time period.
- Budgeting is the process of creating a plan to spend your money.



- Budgeting is simply balancing your expenses with your income.
- An estimation of the revenue and expenses over a specified future period of time

A. detailed breakdown of costs/revenues is needed for attaining profit/personal goals: Firms/peoples have to analyze operations to develop reliable estimates of revenues & costs.

1. If budgeting is done right, it forces better thinking about the firm's/peoples goals & purpose & how to achieve them. It forces management/peoples to ask what to be done if certain target levels of sales & costs are to not being realized.

B. Making realistic budgets requires clear thinking; as a financial plan of firm's/people's expectations over time, it should be an assessment of what each part of a firm/each activity of a person can accomplish

1. Make separate budgets for each part of business: e.g., for a seed firm there should be separate budget for fertilizer, sales, and production& storage divisions.

2. Combine these to make firm's/households total budget: The separate division budgets can then be put together into one master budget for the entire enterprise.

Why is Budgeting so Important?

- It ensures that you will always have enough money for the things you need and the things that are important to you.
- Keep you out of debt or
- It is a tool which helps to measure business performance.

Benefits of Budgeting

1.2 The importance of setting financial goals

1. Acts as a road map – Creating a budget will reveal where every Birr is currently being spent. The visual representation of the actual expenditures reveals the direction followed. When the course being followed is incorrect, the budget can be used to re-route your plan. The budget is a living document that must be updated with the changes that occur in your life.

2. Reveals waste - A detailed budget that is compared against the actual monthly expenditures will reveal the incorrect use of money. When money is spent on non-budgeted items, budget shortfalls are created and can be corrected. When you can identify a source of waste you can then take corrective action.

3. Builds new habits – Efforts to stay within the budget will build new spending habits that can be maintained over time. Working within the budget will shift actual expenses from unnecessary categories into the most essential household categories. Money will be available for the most important expenses and debt reduction becomes possible.

4. Reduces stress – Following the budget throughout the year gives everyone an accurate picture of the financial health of the family. Guesses are no longer required to determine if large purchases and vacations are affordable. When annual expenses are budgeted each month, sufficient funds will exist to pay the bill when it becomes due.

5. Controls spending – If expenditures exceed budgeted amounts, corrections can be made in the coming months to control the monthly flow of money. When outstanding debt is weighing on the monthly finances, the budget can show areas where spending can be reduced to find the money to repay the debt.

6. Coordinates efforts – Setting budget amounts allows every family member to provide input. If the family goal is to have an annual vacation, simple reminders can be given in response to why money cannot be spent on other categories until enough money is saved for the vacation. The budget acts as a barometer for the family finances.

7. Transforms money into a tool – Budgeting all monthly expenditures will change the mindset toward money. Instead of spending impulsively, **money will be valued as a tool to reach goals and fulfill needs. Children raised under a budget will learn the value of money because they are involved in some of the decisions necessary to establish the budget.**

8. Creates margin – Debt repayment and living according to the budget will move the family toward living within the monthly income. As less money is spent, excess income becomes available and is considered financial margin. These funds can then be applied to other financial goals.

9. Grows savings – Budgeting activities make money available to save some of the monthly income for various reasons. Short- and long-term goals can be reached through savings efforts that seemed impossible just months before a budget was created. Savings becomes the highest priority and money can be saved ahead of paying the bills **since every expense is closely monitored and compared to the budget.**

11. Accelerates financial goals – As margin is created within the financial budget and savings becomes a priority, the family can move toward major goals like funding college education for each child. Many goals can be set and reached because the budget has been used consistently to monitor the financial activities.

While budgeting requires some time in the early months, learning to maintain a budget will pay dividends in ways never imagined. Schedule monthly budget reviews and stick to a strict plan to bring the financial health of the family in line with the goals. **Reward the family for staying within the budget and remember that not all rewards are monetary.**

Budgeting is the most basic and the most effective tool for managing your money. Yet, most people avoid doing it because it is additional work, much like cutting your lawn or fixing the roof. Budgeting also connotes that you have to give up and stop yourself from enjoying stuff.

What budgeting actually does is clearly show you how you allocate your money and present you the choices on what stuff to enjoy – based on your financial limitations. It will save you the grief of overspending and being too much in debt. Budgeting does not stop you from enjoying stuff, it ensures that you enjoy stuff when you want it.

1.3 Obstacles that might prevent financial goals being achieved

2. **Lack of resources (proper resources analysis & utilization)**. Decisions that affect expenses whether they are day-to-day living expense decisions or long term debt decisions, like student loans, lead to an inability to save adequately for long term financial goals.

3. **No goals in the first place**. We call this the "seat of the pants" plan. Without a roadmap any highway will take you there. The majority of baby boomers might fit into this category. For most of them it's too late and they are going to work many more years and retire at a much lower standard of living than they otherwise might of because they never planned ahead.

According to Wilder, the seven obstacles to financial success are:

- **Debt.** Not all debt is bad, of course. A reasonable mortgage on a sensible home is fine. But consumer debt — or a bad mortgage on a big house — is an enemy to financial success. In fact, bad debt may be the biggest enemy to financial success.
- **Taxes.** It's our responsibility to pay the taxes we owe, but we're under no obligation to pay more than that. "It is not unpatriotic to reduce paying your taxes," Wilder writes. We should instead actively work to keep our tax burden as low as possible.
- **Inflation.** Inflation is wealth's silent enemy. It will not destroy you all at once. But it's always there, nibbling at the corners of your life, consuming a little cash every year. It's impossible to keep inflation completely at bay, but you can learn to mitigate its effects.
- **Investment mistakes.** As many investors have learned recently, poorly structured investment portfolios can be a killer. This obstacle is overcome through education, through an understanding of diversification and asset allocation, by taking the emotion out of investing.
- **Emergencies.** The final barrier to financial success is the unexpected: unemployment, death, illness, and legal complications. Without a plan for emergencies, you leave yourself at the mercy of the fickle fates. Carry adequate insurance and maintain an emergency fund!

Lackofinformation2.Lackofskill3.Limitingbeliefs4.Wellbeing5.Otherpeople6.Own motivation7.Time8.Money9. Fear

Lo 2. DEVELOP A PERSONAL BUDGET

A **personal budget** is the money that will be allocated to an individual/s to meet their eligible expenses &needs.

A spreadsheet is a sheet of paper that shows accounting or other data in rows and columns; a spreadsheet is also a computer application program that simulates a physical spreadsheet by capturing, displaying, and manipulating data arranged in rows and columns. The spreadsheet is one of the most popular uses of the personal computer.

In a spreadsheet, spaces that hold items of data are called cells. Each cell is labeled according to its placement (for example, A1, A2, A3...) and may have an absolute or relative reference to the cells around it. A spreadsheet is generally designed to hold numerical data and short text strings. Spreadsheets usually provide the ability to portray data relationships graphically. Spreadsheets generally do not offer the ability to structure and label data items as fully as a database and usually do not offer the ability to query the database. **In general, a spreadsheet is a much simpler program than a database program.**

How to create a budget spreadsheet

Building personal budgets, video, F:\texts\texts\excel\Infiniteskills - Microsoft Excel For Business Training Video\03. Managing Money With Excel\03_02-Building Budgets - Part 1.mp4

Building personal budgets.xls

House hold budget.xls

Using spreadsheets to help you plan your budget can be useful because it can help with complex calculations and you can see at a look in-comings and outgoings. It also means that any changes to figures can be automatically updated in calculations by the spreadsheet so that it does all the hard work.

Using a budget in this way can be used for many different things such as preparing for Christmas, vacations, household capital purchases etc.

2.3 Identify and List All Sources of income, *Fixed Expenses* and *Variable Expenses*

A. Sources/Types of Income

In fact, when you get right down to it, there are **three broad types of income** you can generate:

1. Earned Income

2. Portfolio Income(A money witch held by bank and earn for the owner **by selling an investment**)
3. Passive Income

1. Earned Income

Earned income is any income that is generated by working. Your salary or money made from hourly employment (regardless of whether that salary or hourly income came from working for someone else or from your own "consulting") is considered earned income.

Some activities that generate earned income include:

- Working a job
- Owning a small business
- Consulting
- Gambling(kumar)
- Any other activity that **pays based on time/effort spent**

While earned income is the most common mechanism for making money, its **obvious downside** is that **(1)**once you stop working, you stop making money. Additionally, because the amount of money that is made through earned income is directly proportional to the time and effort you spend working, **(2)**it's difficult for someone to make more earned income without either learning a new (or more valuable) skill or working longer hours. Additionally, **(3)**earned income is taxed at a higher rate than any other type of income.

One huge benefit of earned income over the other income types is that **(1)** you generally don't need any startup capital in order to make earned income, which explains why most people rely on earned income from the start of their working life. **(2)** In fact, earned income is a great way to start your investing career, as it allows you to save up cash that will help you generate the other two types of income…

2. Portfolio Income

Portfolio income is any income generated **by selling an investment** at a higher price than you paid for it. Some people refer to portfolio income as **"capital gains,"** because that's how the money is taxed by the federal government.

Some activities that generate portfolio income include:

- **Trading (buying/selling) Paper Assets (money/capital market instruments)**— Paper assets refer to things like stocks, bonds, mutual funds, ETFs, CDs, T-bills, currencies or other types of futures/derivatives. Stock market investing is the most common generator of portfolio income
- Buying and Selling **Real Estate** (specifically the profit from the sale)

- Buying and Selling of **any other Assets** — Antiques or **cars**, for example, or other types of **collectibles** that have appreciated in value

There are a number of downsides to portfolio income; for example:

- **Require knowledge of speculation.** It often takes a good bit of knowledge and experience to learn how to make money trading paper assets. Unless you have inside knowledge of the companies you're trading, you must learn to read financial statements or how to analyze market trends if you hope to beat the market
- You often **have little control over your investments**, other than your ability to buy or sell. For example, buying stock in a company still affords you no day-to-day control over the operation of the company, and therefore little day-to-day control over your investment
- Generating portfolio income generally **requires you to have money to invest upfront**. **Even large gains are inconsequential when the investing amounts are very small (economies of scale, synergy…)**
- Portfolio income is **often taxed at very high rates — equivalent to earned income in many cases**

Portfolio income certainly has **some advantages** over earned income. **(1)** Once you have the knowledge and experience to generate portfolio income on a consistent basis, you can continually reap the benefits (compound your return) by reinvesting after each sale. **(2)**Additionally, any portfolio assets held long-term are generally taxed at a lower rate.

Discuss: the tax rate on long term/capital market instruments investment vs. short term/money market instruments investment. A). on which one do you think is the smaller? B). why???

3. Passive Income

Passive income is money you get from assets you have purchased or created. **(1).** For example, if you were to buy a house and rent it out for more money than it costs you to pay your mortgage and other expenses, the profit you make would be considered passive income. **(2).** As another example, if you owned a business that could operate independently of your working for it, any money that you make from the business would be considered passive income (of course, if the businesses success was limited by the number of hours you worked, the income you made would be considered "earned income").

Some activities that generate passive income include:

- **Rental Income or Note Income from Real Estate**
- **Business Income** (assuming it's not earned based on amount of time/effort spent — that would be Earned Income)
- **Creating and Selling Intellectual Property** — Books, Patents, Internet Content, etc
- **Affiliate or Multi-Level Marketing**

There are some **major benefits** to passive income over the other two types of income:

- Passive income is **generally recurring income**; once the investment is made, and assuming it is a good investment, the income will continue to come in month-after-month or year-after-year, with little additional work by you. This means that you can essentially "retire" and still continue to grow your net worth
- Investments that generate passive income usually **allow the owners active control over the investment.** For example, if you owned an apartment building or a corporation, you would have say in the day-to-day operations that would ultimately impact the success of your investment
- Passive income investments often allow for the most favorable tax treatment. Corporations can use profits to invest in other passive investments (real estate, for example), and take tax deductions in the process. And real estate can be "traded" for larger real estate, with taxes deferred indefinitely
- **Because it is generally possible to closely approximate the return (or at least the risk) you can expect from passive investments, these investments can often be funded using borrowed money.** For example, a good business plan can attract angel funding or venture capital money. And real estate can often be acquired with a small down payment (20% or less in some cases) with the majority of the money borrowed

As you might suspect from the above overview, **many people consider passive income the holy grail of investing, and the key to long-term wealth.**

B. FIXED EXPENSES

Expenses which do not change in response to reasonable changes in sales or other activity

Fixed and Variable Expenses

Business expenses are categorized in two ways: fixed expenses and variable expenses.

Fixed expenses or **costs are those that do not fluctuate with changes in production level or sales volume.** They include such expenses as rent, insurance, dues and subscriptions, equipment leases, payments on loans, depreciation, management salaries, and advertising.

Variable costs are those that respond directly and proportionately to changes in activity level or volume, such as raw materials, hourly production wages, sales commissions, inventory, packaging supplies, and shipping costs.

A**lthough fixed costs do not vary with changes in production or sales volume**, **they may change over time**. As a result, fixed costs are sometimes called **period costs**. Some fixed costs are incurred at the **discretion** of a company's management, such as advertising and promotional expense, while others are not. It is important to remember that all non-discretionary fixed costs will be incurred even if production or sales volume falls to zero **(Shutdown cost).**

Although **production and sales volume are the main factors determining the level of variable costs incurred by a company**, these costs also may fluctuate in relation to other factors, such as changes in suppliers' prices or seasonal promotional efforts.

Some expenses may have both fixed and variable (mixed) elements. For example, a company may pay a sales person a monthly salary (a fixed cost) plus a percentage commission for every unit sold above a certain level (a variable cost).

DEFINITION OF 'VARIABLE COST'

Variable costs are those costs that **vary depending on a company's production volume**; they rise as production increases and fall as production decreases. Variable costs differ from fixed costs such as rent, advertising, insurance and office supplies, which tend to remain the same regardless of production output. Fixed costs and variable costs comprise total cost.

2.4. Calculate surplus (profit) or deficit (loss) budget

Budget Surplus

This happens if the income weights more than your spending/expenses
e.g. Income = 2000 birr

Spending (cost) = 1300 birr

Budget surplus is **700** birr.

How Does A Budget Surplus Happen?

- Peoples may have cut back on their spending
- people increase their income

Budget Deficit

This happens if Peoples spend more money than their income.
E.g. Income = 2000 Birr

Expense/Spending = 2100 Birr

Budget Deficit/ loss =**100** Birr

How Does A Budget Deficit Happen?

- People may have spent more money.
- Lower income.
- Inflation

2.5 Ways to Reduce Expenses or Increase Income

A) .Ways to Reduce Expenses

1. Reduce your food bill
2. Take advantage of free entertainment
3. Don't pay (much) for a gym membership
4. Remember that fashion is fleeting, but clothes are not

B). Ways to Increase Income/Revenue

1. Start a Side Business
2. New Job with a New Employer
3. Take On An Extra Job
4. Work More Overtime
5. Create an Extra Business
6. Other Family Members Contributions
7. Government Support & Tax Breaks
8. Maximize Asset Earning

LO 3. IMPLEMENT AND MONITOR THE PERSONAL BUDGET

3.1 Plan and budget

What's the difference between a budget and a financial plan**?**

A personal budget...

A personal budget is essentially a guideline to follow with regards to spending. It breaks down expenses into categories (i.e. rent, electric bills, etc..) for a certain time period (usually weekly, monthly, or yearly).

Once all expenses are put into the budget, they're added up to get a total. This figure is then used to subtract against the total amount of income made for the same time period. The result is how much money can be saved for that time period. If the goal is to save more money, then expenditures can be changed or dropped from the budget (if possible).

A financial plan...

A financial plan is a tool to help you achieve long-term financial objectives. It's kind of like a budget in that it breaks down your expenses, but **it's much more goal-oriented.**

For example, let's say your goal is to save up a certain amount of money for retirement. A financial plan would be your guideline for reaching that retirement goal. Financial plans also differ from budgets because they focus more on income and assets.

3.2 COMPARISONS OF ACTUAL EXPENSES AND INCOME

Actual expenses and income for the period during which the budget is implemented are recorded and compared to budgeted expenses and income with any differences in budgeted and actual amounts looked at and the budget modified where necessary.

Actual Expenses Compared to Budget

Budgeted- The amount we budgeted (expected to spend and earn) for the future, first quarter of 2006

Actual -The amount we actually spent and earned, for the first quarter 2019

Difference- The difference between the budget and actual expenses in Birr or %

The difference between the budget and actual expenses as a percentage

- ✓ Above 100% means we were over budgeted
- ✓ Less than 100% means we were under budgeted.

Develop Understanding of Debt and Consumer Credit

Dear learner after completing this competency you will be able to:

LO1 Identify and discuss the role of credit in society
LO2 Identify and discuss the range of credit options available
LO3 Identify and discuss costs of using credit
LO4 Analyze and discuss the effective use of consumer credit
LO5 Manage personal credit rating and history

What Is Credit?

Credit can be a valuable addition to your financial tool box if you use it carefully and sensibly. **Credit** means someone is willing to loan you money—called **principal**—in exchange for your promise to repay it, usually with interest. **Interest** is the amount you pay to use someone else's money. So the higher the interest rate, the higher the total amount you pay to buy something on credit.

The best part about credit is that it lets you buy something—like a car or a year of college tuition—you couldn't otherwise afford if you had to pay for it all at once. You get to buy the item now but pay for it over a period of time, usually with interest.

LO1 Identify and discuss the role of credit in society

1.1 The concepts and terminology of credit provided by a financial institute and debt incurred by a borrower are analyzed and discussed

1.2 The historical and current ***role of consumer credit*** within the society is identified and ***advantages and disadvantages of credit*** use are analyzed and discussed

- Enabling approved applicants the ability to purchase items (goods and/or services) where the cost of the item exceeds current savings available.

Advantages and disadvantages of credit

- obtain and can use purchased item immediately
- minimizes the need to carry cash or write cheques
- allows for installment payments on expensive items
- convenient form of payment when travelling, especially

Disadvantages:

- may increase cost of items purchased due to interest
- usually attracts other fees such as account servicing fees
- can lead to compulsive buying habits

1.3 discusses and analyzed the impact of consumer debt on the national economy

Consumer debt contributes to **economic** growth. As long as the **economy** grows, you can pay off this **debt** more quickly in the future. That's because your education may allow you a better-paying job. That creates an upward cycle, boosting the **economy** even more.

LO2 Identify and discuss the range of credit options available

2.1 Types of ***credit facilities*** used by businesses are analyzed and compared

- personal loans
- leases including mobile phones, cars, business premises,
- office equipment including personal computers
- hire purchase
- 'buy now, pay later' schemes
- revolving:
- credit cards
- store cards

2.2 Types of credit facilities used by individuals are analyzed and compared

The Various Types of Credit Facilities

- **Credit Card**. With a good credit history and steady income, you may qualify for **credit cards** at the bank. ...
- Personal Loan. Personal loans are mostly unsecured in nature. ...
- Bridging Loan. ...
- Motor Vehicle Loan. ...
- **Bank Overdraft**. ...
- Restructured Loan. ...
- HDB Loan. ...
- Renovation Loan.

HDB (Housing Development Board) (Singapore government agency)

An **HDB loan** or home **loan** is money borrowed from **HDB** or the bank to help you buy your property. For **HDB** flats, you may also be able to tap on housing **loans** at a concessionary interest rate, subject to **HDB's** criteria. ... Your property is used as collateral for the **loan**. The amount granted is based on eligibility

Differences between unsecured and secured loans are analyzed and discussed

- a secured loan is supported by an underlying asset while an unsecured loan is not
- Unsecured loans attract higher interest rates due to increased risk to the lending institution.

2.3 ***Implications of default*** on secured loans are explained to the client

- any shortfall in sale of repossessed asset against outstanding loan amount must be paid by borrower
- Repossession of the underlying asset by the lending institution.

LO3 Identify and discuss costs of using credit

3.1 Fees and costs **associated with different types of credit options are** ***analyzed and compared***

The difference between **cost** and **expense** is that **cost** identifies expenditure, while **expense** refers to the consumption of the item acquired. These terms are frequently intermingled, which makes the difference difficult to understand for those people training to be accountants.

3.2 The features and associated risks of fixed versus variable interest rates are analyzed and compared

3.3 ***Ways to compare advertised interest rates*** and the effects of fees and charges are analyzed and discussed

- Informing the client of the 'comparison rate' which includes all associated fees and charges.

LO4 Analyze and discuss the effective use of consumer credit

4.1 Ways to avoid excessive or unmanageable debt are analyzed and discussed

4.2 ***Strategies to minimize fees*** on credit are identified and discussed

- consolidating savings and credit facilities with the one institution where account servicing fees can be cancelled out
- knowing how many free transactions come with the card
- Paying the minimum monthly installment on time. 4.4 ***Ways to avoid credit card fraud*** are identified, analyzed and discussed
- not disclosing Personal Identification Number (PIN) to anyone
- selecting a PIN only the card holder would know
- Signing the back of the credit card.

LO5 Manage personal credit rating and history

5.1. The role of credit reference agencies is analyzed and discussed

5.2 The purpose and use of *credit reference reports* in assessing loan applications is analyzed and discussed

- reports established and maintained by credit reference agencies which record all negative events (i.e. defaults) listed

by creditors against debtors.

5.3 ***Implications of establishing a poor credit history*** are analyzed and discussed

- higher interest rate penalties
- inability to obtain finance in the future
- may disadvantage applications for rental accommodation
- Necessity to obtain guarantor in future loans.

5.4 The right to access and ***methods of obtaining own credit reference report*** are analyzed and discussed

ACCOUNTING TVET LEVEL II TTLM

BASIC ACCOUNTING WORKS LEVEL II

Unit of Competence: Develop and Use a Savings Plan

Module Title: **Developing and Using a Savings Plan**

LG Code: **BUF BAW2 09 0812**

TTLM Code: **BUF BAW2 M09 1212**

MODULE DESCRIPTION:
This TTLM Consists of This unit describes the performance outcomes, skills and knowledge required to develop and implement a savings plan to achieve identified goals, including identifying savings goals, understanding the role of the savings plan, the risk/return relationship and how to determine appropriate savings vehicles to maximize savings.
LEARNING OUTCOMES: **At the end of this module trainees will be able to:** LO1 Discuss the place of saving and investing today LO2 understand risk as it relates to saving and investing LO3 Develop your own savings plan LO4 Implement your own savings plan

LO1, Discuss the place of saving and investing today

1.1 The impact of increasingly high cost of living in society is discussed using examples from the domestic environment

1.2 Increasing levels of ***consumer debt*** in Ethiopia are discussed with reference to relevant current issues

Consumer debt may refer to:	• credit card debt • mobile telephone debt • mortgages on residential and investment properties • personal loans to purchase: ➢ motor vehicles ➢ travel ➢ domestic white goods • store credit • Student loans including the Higher Education Contribution Scheme.

1.3 The importance of setting ***financial goals*** and developing a Saving and investment plan at different stages of an Individual's life is analyzed and discussed

Financial goals may include:

- the future for the purposes of:
- purchasing assets
- financing holidays, educational expenses, home
- renovations and other known future expenses
- establishing a deposit for an investment such as a home or
- investment property
- aiming to repay existing debts and be debt free
- establishing a regular savings plan
- handling income and expenditure responsibly and avoiding

1.4 Different ***attitudes to savings and investment*** are Analyzed and discussed and the individual's own spending Habits are explored

Attitudes to savings and investment differ and may encompass those who:

- believe it is essential in order to manage their money and
- achieve future financial goals
- lack interest in or the discipline to save and therefore live from
- one pay packet to the next
- Occasionally think about saving but who do not take active steps to save.

LO2 Understand risk as it relates to saving and investing

2.1 The concept of ***risk*** and ***risk versus return*** is explained and demonstrated

- the higher the risk of the investment, the higher the expected return
- The lower the risk of the investment, the lower the expected return.

2.2 An individual's ***risk profile*** is determined based on current and future requirements and the individual's level of risk aversion

- The level of risk an individual is comfortable with when investing the money.

2.3 The impact of ***inflation*** on the earnings power of money is identified, assessed and discussed

- the cost of living, indicated by the inflation rate
- the percentage change in the Consumer Price Index which is
- a quarterly survey of the retail price of a basket of goods and
- Services consumed by the general population.

LO3 Develop your own savings plan

3.1 Personal savings ***goals*** are identified and quantified into dollar amounts and arranged in order of priority

Goals need to be:

- specific
- measurable
- achievable
- realistic
- Timely.

3.2 A personal budget is developed to reveal funds available to contribute towards savings goals

3.3 The range of financial product options available to maximize earnings on savings are investigated and the most appropriate is selected according to own requirements

- basic savings account
- cash management trusts
- fixed term deposits

LO4 Implement your own savings plan

4.1 evidence of personal identity are researched and steps taken to gather the necessary documentation

4.2 Relevant savings accounts or other investigated financial products are opened and the savings plan implemented and monitored for a short period of time

4.3 Adjustments to the savings goal are made where it is realized that the goal is unattainable

END