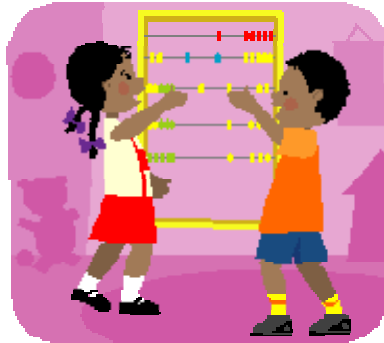


# INCOMES AND EXPENSES



## EDUCATOR MEMORANDUM

*In this Financial Literacy chapter learners will:*

1. Differentiate between personal incomes and personal expenses.
2. Determine examples of personal incomes and expenses.
3. Compile a personal statement of net worth.
4. Gain an introduction to business incomes and business expenses.
5. Study different possibilities of investments for businesses.



**NOTE:** To avoid the cumbersome use of 'he or she' and 'his or her', the learner will be referred to as 'he' or 'his'. This does not reflect any sexism on the part of the authors, but is simply more practical.

All exercises with assessment rubrics use the following rating scale:

<i>Key to Assessment rubric</i>		
Level	Description of competence	Percentage
7	Outstanding achievement	80-100
6	Meritorious achievement	70-79
5	Substantial achievement	60-69
4	Adequate achievement	50-59
3	Moderate achievement	40-49
2	Elementary achievement	30-39
1	Not achieved	0-29

## PERSONAL INCOME

According to [www.investorwords.com](http://www.investorwords.com), personal income is all the earnings of an individual from wages, passive enterprises, investment interest and dividends. *Disposable personal income* refers to the income that remains after income tax has been paid. This is the amount of money that the individual can spend or save.

A report compiled by the Bureau of Market Research at the University of South Africa (UNISA) entitled 'Personal Income Estimates in South Africa, 2010', estimated the distribution of income in South Africa for 2010. The table below shows the adult (older than 16) population of South Africa divided according to province and income group.



Province	R0-50 000	R50 000 – R100 000	R100 000 – R300 000	R300 000 – R500 000	R500 000 – R750 000	R 750 000 +	Total
	Pop No.	Pop No.	Pop No.	Pop No.	Pop No.	Pop No.	Pop No.
Eastern Cape	4 015 683	241 578	305 595	69 794	15 580	10 423	4 660 652
Free State	1 589 294	200 037	198 014	39 097	12 866	9 558	2 048 867
Gauteng	4 153 606	936 226	1 250 228	316 433	119 858	94 983	6 871 334
KwaZulu- Natal	5 004 332	582 102	591 856	111 915	44 013	24 821	6 359 041
Limpopo	2 874 758	177 523	154 491	43 475	16 773	10 669	3 277 690
Mpumulanga	1 957 794	206 978	158 625	45 696	20 834	14 088	2 404 016
North West	1 806 266	233 440	226 447	43 352	18 672	11 120	2 339 297
Northern Cape	626 854	61 350	72 629	15 101	3 967	4 260	784 161
Western Cape	2 031 591	567 211	531 664	104 881	50 204	37 648	3 323 198
<b>Total</b>	<b>24 060 179</b>	<b>3 206 445</b>	<b>3 489 549</b>	<b>789 744</b>	<b>304 767</b>	<b>217 570</b>	<b>32 068 255</b>

[www.unisa.ac.za/contents/faculties/ems/docs/Press396.pdf](http://www.unisa.ac.za/contents/faculties/ems/docs/Press396.pdf)

The research showed that Africans and Whites make up the majority of adults in the higher income groups. Africans dominate the emerging middle class income group of R50 000 – R300 000 p.a. (per annum or per year). Whites still constitute the majority of the R300 000+ income groups.



The higher income groups experienced much higher levels of growth than the middle income groups from 2009 to 2010. This meant that the recession had quite a severe impact on the emerging middle class in South Africa.

Income distribution (how income is spread across the population) in South Africa is very unequal. During 2010, 1.6% of the adult population earned incomes of over R500 000 a year, which comprised almost a quarter (24.6%) of all personal income in South Africa.

75% of the adult population still falls into the R0 – R50 000 p.a. income group despite relatively high levels of economic growth over the last 20 years. This means that less than 25% of the South African adult population contributes towards income tax (the current tax threshold is about R60 000 p.a.).



## Types of Personal Income

The most common type of income is *earned income*. This shows a direct link between a person's time and their income. If someone works for eight hours, they will be paid for eight hours. It is the income that is received for a person performing their job. This type of income is paid in the form of wages or a salary.



*Residual income* is a financial reward that is earned repeatedly without any extra effort after a person has done something correctly once. Examples of this type of income would be money received from property rental or royalties earned on books, advertisements, etc.



*Leveraged income* is income that is earned in conjunction with the combined efforts of other people. People who join a marketing group like Amway gather other people underneath them in the structure. They earn money from their own activities as well as those of the people who fall underneath them. J. Paul Getty, who was an American industrialist, said, "I will rather earn from 1% of 100 people's effort than from 100% of my own effort."



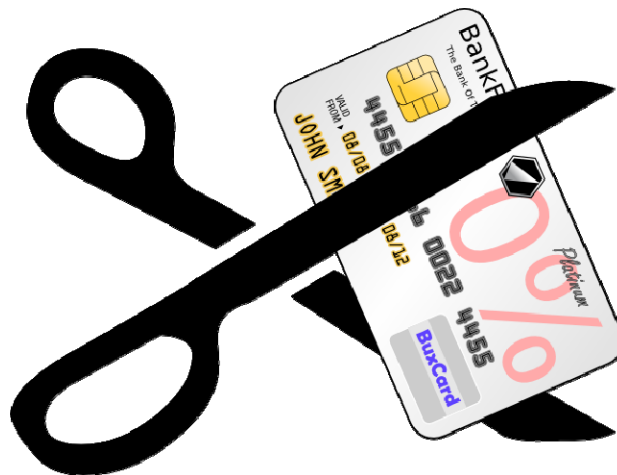
*Passive income* is any income that does not require a person's time (or very little) in order to sustain it. Investments and high interest bearing accounts are examples of passive income. The terms 'passive' and 'residual' income can be used interchangeably.



## PERSONAL EXPENSES

Personal expenses are all the things that individuals spend their money on in order to maintain their lifestyle. In reality, it often occurs that people have greater expenses than incomes and this leads to financial problems.

This is made worse by the availability of credit offered to individuals in the form of credit cards and loans. In South Africa, the National Credit Act was introduced in 2005. This made it more difficult for people to qualify for credit. Although this may seem unfair, it in effect protects people from having too much credit that they may not be able to repay.

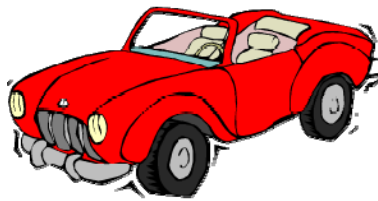




## PERSONAL STATEMENT OF NET WORTH

Today's technology makes it easy to keep a permanent record of personal financial records. Many households have access to a computer, whether at work or at home. Spreadsheets, like those created in MS Excel, can be used to draw up budgets (personal financial plans) and statements of net worth on a monthly or annual basis.

A statement of net worth is similar to a business's Balance Sheet in that it shows a person's financial status at a certain point in time. It can be defined as the difference between what you own and what you owe! It takes into account money earned and spent, as well as any money owing to others. Net worth is what a person has, at that point in time, to show for all the money they have earned over their lifetime.



When compiling a net worth statement, complete the following steps:

1. Gather all records of *assets* and their values, e.g. money in bank accounts, investments, etc.
2. Formulate a list of all *liabilities* (money owed) and their balances (what is currently owed), e.g. home loans, study loans, etc.
3. Calculate the net worth by subtracting 2 above from 1 above.



### TARGET PRACTICE 2

- ✓ Use the template below as a guideline to create a statement of net worth for Ben Tennyson, a 13-year-old, on an MS Excel spreadsheet. Use formulas to calculate the sum of each column, and to find the net worth.
- ✓ Hand in the spreadsheet as an Excel spreadsheet (so your teacher can see your formulas) as well as a printed hard copy.



Ben earns R120 pocket money per month and currently has R280 in his savings account. His neighbours are away and he is feeding their dogs and fish for the month and has earned R200 for this. It is school holidays and he went to Jozi-X (R100), to the movies, R50 with popcorn, and tenpin bowling, R75 with a burger and cold drink afterwards. He and his friends also went to Adventure Golf, R50 and the Sci Bono Museum, R40. This month was Ben's 13<sup>th</sup> birthday and he received R950 from his friends and family. He used some of the money for a new pair of soccer boots, R450 and a new Super Mario Brothers Wii game for R490. His mom loaned him R300 two months ago which he is paying back over 6 months. (He has paid her back R100 so far.) Ben's family are big investors and his aunt has taken out R500 of SATRIX 40 shares in his name. His grandparents opened an Allan Gray unit trust account in his name three months ago to the value of R1 000. They pay an additional R400 a month into this account.





What is his net worth at the end of the month?

(25)

Statement of Net Worth		
	Money In	Money Out
<b>ASSETS</b>		
Investments....	<b>2 300</b>	
<i>Satrix 40</i>	<i>500</i>	
<i>Allan Gray unit trusts (1 000 +400+400)</i>	<i>1 800</i>	
Cash (earning and spending)...	<b>45</b>	
<i>Savings account</i>	<i>280</i>	
<i>Pocket money</i>	<i>120</i>	
<i>Jozi-X</i>		<i>100</i>
<i>Movies</i>		<i>50</i>
<i>Ten-pin bowling</i>		<i>75</i>
<i>Adventure Golf</i>		<i>50</i>
<i>SciBono Museum</i>		<i>40</i>
<i>Birthday money</i>	<i>950</i>	
<i>Soccer boots</i>		<i>450</i>
<i>Super Mario Brothers Wii game</i>		<i>490</i>
<i>Loan repayment</i>		<i>50</i>
<b>LIABILITIES</b>	<b>150</b>	
<i>Loan</i>	<i>150</i>	
<b>NET WORTH</b>	<b>2 195</b>	<i>Calculation(2 300+45-150)</i>

## BUSINESS INCOME

Business income is a type of earned income and is any income that is realised as a result of business activity. This refers to *Sales* in a retail or manufacturing business (where goods are sold to customers) or *Current Income* in a service business. Commission can also be earned in businesses like estate agencies when they sell properties on behalf of their clients – this is called *Commission Income*.



Businesses can also retain some of their profit in a *reserve fund*. This money can earn interest from the financial institution at which it is invested. This income is called *Interest Income* and is a passive income.

Some businesses want their money to grow faster than it would in a savings or fixed deposit account in a financial institution. They may invest some of the reserve fund in other ways, like purchasing *shares* in public companies. In this way, the business should earn *dividends* (a share of the company's profit paid out to each shareholder) on an annual basis and hopefully the price of the shares will rise over time. This will mean greater assets for the business.

Many companies purchase a great many shares in other companies so that they actually have a say in the management of the other company. Often, if someone (or some business) owns 10% of the shares of a company, they can request a seat on the board of directors. If one company owns 30% of another company's shares, it is said to be a holding company. When more than 50% of a company's shares are owned by another company, it is a controlled company. Bidvest is the most diversified company in South Africa, with controlling interests in businesses ranging from banking and cabling, to food and transport.



Businesses can purchase *property* that can be rented out to other individuals or businesses. Income generated in this way is known as *Rent Income*.



## BUSINESS EXPENSES

Business expenses are all expenses that are incurred in the ordinary course of business. This includes all day-to-day running costs. Expenses are generally tax deductible because in South Africa businesses are only taxed on their profits. Remember that profit is the difference between incomes earned and expenses incurred.



The main types of expenses that most businesses have are:

- **Cost of sales** – In a manufacturing business, this is the total cost to the business to make a finished product. It includes raw materials and semi-finished goods. For a trading concern, cost of sales involves the cost of purchasing the items from the supplier. The selling price is calculated based on a percentage mark-up on the cost of the goods to the business. The difference between the sales price and cost of sales is called gross profit.

*Example:* Mr Price purchases jeans from its supplier at R100 a pair. They have a 50% mark-up on all their clothing. The jeans will be sold for R150 a pair. When a pair of jeans is sold, the Sales account will have an entry of R150 and the Cost of Sales account will have an entry of R100. The gross profit for the sale of one pair of jeans is therefore  $R150 - R100 = R50$ .



(There are other accounts involved which you will learn about in Grades 8 and 9.)

- **Salaries and wages** – Paying employees for their labour is probably the largest expense of any business. Wages are paid weekly and salaries are paid monthly.
- **Operating or running expenses** like water and electricity, telephone, rent expense (if the business is renting the building it operates from), vehicle expenses and consumable stores need to be paid monthly. These expenses must be budgeted for every month and are normally around about the same amounts monthly.
- **Indirect** expenses like stationery, advertising and marketing costs do not occur every month but also affect the net profit of a business.

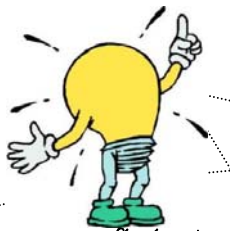




**TARGET PRACTICE 3**

In the previous chapter, we diagnosed the assets of the businesses below. Work in pairs and make a list of all the possible expenses you think that these businesses may encounter on a monthly basis.

Mugg & Bean franchise	Simba Chips factory	Hairdresser working from home
<i>Rent of the shop</i> <i>Electricity</i> <i>Cleaning materials</i> <i>Printing costs of menus</i> <i>Waitrons uniforms</i> <i>Cleaning materials</i> <i>Insurance</i> <i>Maintenance on kitchen appliances</i> <i>Salaries and wages</i>	<i>Salaries and wages</i> <i>Maintenance of machines</i> <i>Insurance</i> <i>Water and electricity</i> <i>Cleaning materials</i> <i>Telephone</i> <i>Stationery</i> <i>Consumable stores for workers (tea, coffee, sugar, toilet paper, etc.)</i> <i>Fuel for delivery vehicles</i>	<i>Hair products like colouring, shampoo and conditioner used for clients' hair</i> <i>Cleaning materials</i> <i>Consumables stores for clients and employees</i> <i>Salaries and wages</i> <i>Water and electricity</i> <i>Telephone</i>
<i>Take the learners' opinions</i>	<i>into account.</i>	



**LIGHTBULB MOMENT!**

So, gross profit is the difference between sales and costs of sales. Net profit or net income is gross profit plus any other incomes, minus all the other business expenses.

**SAVINGS & INVESTMENTS IN BUSINESS**

When a business turns a profit it has extra money at its disposal. Just as individuals must plan for their retirement by putting aside money in the form of savings, pensions and investments, businesses must also utilise any additional capital they have as optimally as possible. In other words, they need to make their money grow as much as they can.

All businesses must have a *current* bank account which enables them to trade. The business pays money out of that account for all its costs and money received from customers will be deposited into the bank account. However, a current or cheque account does not earn much interest at all. This is because money is continually being processed in and out of the bank account, and so the bank cannot use the money over a long period of time.

The business should always have enough money in its current account to cover its monthly expenses as well as a little extra for unplanned circumstances. Any additional money should be invested in other ways in order to provide the business with extra money. This growth in the amount of money is called a return on investment.





Businesses can investigate different ways in which to save or invest their extra money. We will look at a few examples of business investment:

- Money can be deposited in a *call account*. Depending on the time allocation of the account, the accountholder can access his money after giving notice. A 32-day call account means that the business will have access to its money 32 days after giving notice.
- A *fixed deposit* account means that the money invested must remain in the bank until the stated time period has elapsed. Therefore, a 12-month fixed deposit means that the business will only have access to the money after a year. Money deposited into a fixed deposit should not be required by the business in the short term. The interest earned on a fixed deposit account is higher than both a current and a call account.
- Smaller businesses may invest some of their surplus capital in *unit trusts*. Unit trusts are similar to shares in that the money is invested in the Johannesburg Securities Exchange. However, in order to purchase unit trusts, no knowledge of the stock market is necessary as each unit trust fund is managed by an expert fund manager. It is this person's job to purchase a 'basket' of shares on behalf of the investors, and to move the investments according to the risk profile of the fund, and the performance of the different shares within the basket or portfolio.

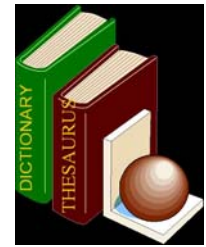


The investor, whether an individual or business, should decide on the level of risk they are willing to take when purchasing unit trusts. High risk funds have more investments in shares, but generally also generate a higher return. However, in a volatile share economy (like the recession of 2008 and the dip in 2011), share prices can drop drastically and along with that, the value of the investment. Lower risk or stable funds will spread the investments over shares, property investment and money market investments. The growth in these types of unit trusts is generally slow, yet steady. Investments in unit trusts should be for a period of at least three to five years – these are referred to medium term investments.

- As discussed before, some businesses buy *shares* in other public companies. A share is a portion of ownership of a public company (a company that is listed on the JSE in South Africa). Any member of the public is welcome to purchase shares, as long as they can afford the share price. The more shares of a company a business purchases, the more of the company it owns. If a business (or individual) buys a few thousand shares in another company, it will only own a small portion of the company and although it may attend the Annual General Meeting (where important decisions can be made) and vote on decisions, its vote will not carry a large weight. Companies usually issue millions of shares to be bought by shareholders.

Shareholders will make money by earning annual dividends and through the increase in the price of the shares. A shareholder can sell his shares at any time and the income he earns will be the difference between his purchase price and his selling price (as long as the selling price is higher!)






## TARGET PRACTICE 4

✓ Using a dictionary or the Internet, find definitions for the following new terms:

❖ Personal income

*An individual's total earnings from wages, passive enterprises, and investment interest and dividends.*

www.investorwords.com

❖ Residual income

*Income earned by doing something once and then earning money from it for a long period of time, e.g. royalties for books, advertisements on a website, etc.*

❖ Cost of sales

*The direct costs (the cost of purchasing or manufacturing the product) of the goods sold.*

❖ Surplus

*The position of a business when it has made a profit (incomes exceed expenses) and the excess money can be invested in other means.*

❖ Fixed deposit

*A deposit of money held at a financial institution for fixed period of time, e.g. 6 months, 12 months or 2 years. The interest earned on the deposit is higher than a savings account.*

❖ Shares

*A unit of ownership of a private or public company which entitles the owner to a share in the profits of the business.*

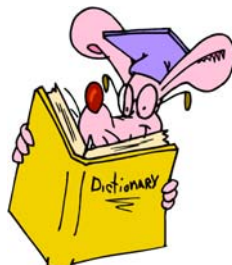
❖ Dividends

*The way in which a company's profits is distributed to its shareholders. A dividend is declared on each type of share in the company.*

❖ Unit trust

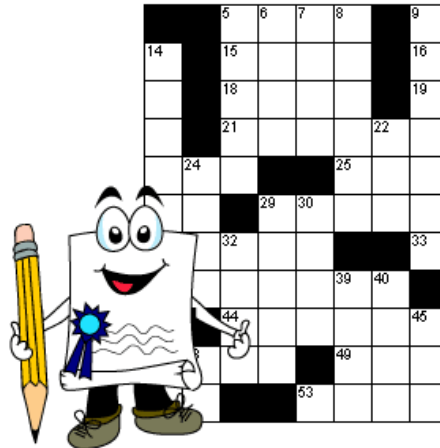
*A collective fund which allows private investors to pool their money into a single fund which spreads their risk across a number of investments.*

(16)



- ✓ Design a crossword puzzle using the definitions above, as well as any 7 other terms from this chapter. Remember that with a crossword puzzle, there must be clues for words across and words down. Words across and down can start at the same point (as long as they use the same letter) and can also intersect one another. The more this occurs, the better the crossword, as the letters completed give clues to other answers.

The crossword puzzles will be distributed amongst the class and each person will be required to complete someone else's crossword. You will complete a peer assessment to evaluate the puzzle you have received. (24)



<b>Peer Assessment: Crossword Puzzle</b>				
<b>Name of learner being assessed:</b>				
<b>Name of learner assessing:</b>				
	<b>No</b>	<b>Partially</b>	<b>Yes</b>	<b>Learner's Mark</b>
Were there fifteen different clues?	0		2	
Are there clues across and down and do they intersect in true crossword style?	0		2	
Are the clues simple yet explanatory enough for a Grade 7 learner's level?	0	1	2	
Did the learner put effort into the crossword?	0	1	2	
Was the crossword neatly presented?	0	1	2	
Did you enjoy completing the crossword?	0	1	2	
Would you recommend it as a fun revision tool?	0	1	2	
What mark would you give the learner out of 10 for his or her crossword puzzle?	Mark out of 10			
<b>TOTAL OUT OF 24</b>				



## TEST YOURSELF

These are the types of questions you could expect in a test on this chapter. This section is also helpful when revising your work. Complete the questions on your own paper.



1. List four types of personal income. (4)

*Earned income*  
*Residual income*  
*Leveraged income*  
*Passive income*

2. Statement of net worth  
 2.1 Why should a person draw up a statement of net worth? (2)

*They are able to see at any point in time what their assets, liabilities and cash flow position is.*

- 2.2 Give four examples of items that will increase net worth. (4)

*Salaries and wages, investments, interest, monetary gifts*

- 2.3 Give four examples of items that will decrease net worth. (4)

*Loans that need to be paid back, living expenses, entertainment expenses, insurance*

3. Explain the following terms:

- 3.1 Commission income

*Commission earned by a salesperson through the sale of a product*

- 3.2 Interest income

*Interest earned on an investment*

- 3.3 Rent income (6)

*Income earned through the leasing of a property or asset to another person or business.*

4. State whether the following transactions form part of the sales of a business, or part of current income. (Hint: Assume with each transaction that you are responsible for the books of the business mentioned.)

Transaction	Sales / Current income
Customers had a dinner at Browns of Rivonia to the value of R680.	<i>Current Income / Sales</i>
The daily takings at the cash register of 14 <sup>th</sup> Avenue Spar amounted to R15 400.	<i>Sales</i>
McCarthy Nissan sold a Nissan Qashqai for R270 000.	<i>Sales</i>
Sam's Salon had 10 clients during the day – each person paid R450.	<i>Current Income</i>
The hairdressers at Sam's Salon sold R900 worth of hair products during the day.	<i>Sales</i>

5. How does a business calculate gross profit? (3)

*Sales (or Current Income) less the cost of sales = gross profit*

6. What is meant by net profit and how will a business calculate it? (5)

*Net profit is the difference between all business incomes and all business expenses.  
Total incomes (Gross profit + other incomes) - Total expenses - Net income*

7. A business has a net profit of R1 250 000. It requires R1 million to cover its business costs for the year. Management has decided that it wants to keep R50 000 in a separate bank account. What type of account should they use? Furthermore, advise the management on how to invest the remaining R200 000. Give them three different options to consider. (15)

*The business should put the money into a call account which earns higher interest but can be accessed at any time.*

*The remaining R200 000 can be invested in a fixed deposit account which will earn higher interest than a call account. The money will be fixed for a certain time period.*

*The business could purchase unit trusts. This involves purchasing a basket of shares through one investment fund. The investor does not need to have in-depth knowledge of the stock market and his risk is spread.*

*The business could purchase shares in other public companies. They could employ the services of a stockbroker to invest on their behalf, or could make the share purchases themselves. The risk in shares is higher, but so is the return on the investment. The share performance must be monitored on a regular basis.*

