

# Enterprise Development Training Course

DAY TWO - SESSION SIX

## The Financial Reality of an Enterprise

**Objective:** to enable participants to describe the sources and forms in which money is being used in a business, and the operating results, in the form of a simple 'balance sheet' and 'profit and loss statement', and to use and explain these statements without employing technical accounting terms.

**Time:** One and a half to two hours.

### Advance Preparation:

It is not necessary, or desirable, to have a qualified accountant to handle this and other sessions which deal with financial figures, since the participants will learn more effectively if they feel they are learning with, rather than from, the instructor. It is nevertheless particularly important that the instructor should be well prepared for these sessions. It may also be useful to ask people who are familiar with local languages how they would translate accounting terminology.

### Session Guide

1. Remind participants of the first session, when they described what they did at work, and identified their strengths and their weaknesses in the field of enterprise development. Some will almost certainly have identified accounts as a weak area, and some may also have said that this was an area where they were strong.

In this and the following sessions, both will learn; those who have some experience of financial accounting will learn how to apply their knowledge to the reality of very smallest businesses owned by poor people, and those who know little or nothing now will by the end of the day be able to use simple accounts in a very practical way.

Those who have some knowledge may also have to 'unlearn', since much of what we learn in accounting is made un-necessarily complicated by unfamiliar words; as we shall see, the basic concepts of accounts are actually very simple and very useful, even for the smallest businesses and for illiterate people.

Some of the material will be very familiar to participants who have accounting experience. They can still learn a great deal about how to explain and use accounting tools to communicate with people who have no such experience. They should act as 'consultants' to their fellow-participants who have no knowledge of accounts, but they must **not** just give the answers, since people learn not from being told but from being helped to discover for themselves.

2. Write the following words on the board:

*Balance Sheet*

*Debtors*

*Creditors*

*Liabilities*

*Reserves*

*Depreciation*

(If the course is being conducted in a language which has its own words for these accounting terms, write the 'formal' words which are used by educated people in the area)

Ask participants to write down translations of these words in a local language which is spoken by many of their poorest clients. This may be a tribal language or a regional language. They should not at this stage discuss their efforts with their neighbours.

Participants may have difficulty, either because they do not know what the words mean in English or because it is difficult to express their meaning in vernacular languages. Tell them to do their best, the very difficulty of the task is the main lesson.

3. Allow about five minutes for this translation. Then ask each participant to exchange his paper with another participant, who has some knowledge of the language that has been used. Ask some participants to translate what has been written literally back into English, or whatever language the course is being conducted in, without using their prior knowledge of the meaning of the original words.

The results will probably be confusing and perhaps meaningless or even quite contrary to the meaning of the original accounting terms. Point out that this shows how difficult it is to communicate with our clients if we try to work with the 'jargon' words which accountants normally use; the objective of this session is to see how simple and practical the underlying tools of accounting really are.

Ask if any participant has recently taken a prescription from a doctor; could she read and understand it herself?

Usually doctors write prescriptions illegibly and using words that ordinary people cannot understand. Like all 'professionals', such as lawyers, priests, engineers and accountants, they wish to preserve the mystery of their craft. Our objective is to break through the mysteries of accounting, and to help our clients to break through them, so that we and they can use the tools ourselves.

4. Ask a participant who has some knowledge of accounts to explain to the rest of the class, in simple words such as can be understood by somebody who has no knowledge of accounting, what each of the six terms means.

Stress that the precise definitions do not matter; what is important is that participants, and their clients, should understand and be able to use the practical accounting tools that the technical terms so often prevent ordinary people from using.

They should say something along the lines of:

- Balance sheet: a description of the financial position of a business, which shows where the money has come from and how it is being used at a particular point of time.
- Debtors: the amount of money that is owed to a business by its customers.
- Creditors: the amount of money that is owed by a business to its suppliers.
- Depreciation: the reduction in value of equipment that results from its being used.
- Reserves: the money that has been reinvested in the business out of its profits.
- Liabilities: the sources from which the money in a business has come.

Ask participants who have no prior knowledge of accounting to suggest simple words that we can use in this and subsequent sessions, in place of confusing words such as 'debtors' and 'creditors' whose meanings we can only remember if we learn them by heart.

Encourage participants to suggest and agree on their own terms, possibly in local languages, and use them in subsequent sessions. In this material we shall hereafter use the following terms, the first four of which are the words used by American accountants, which are generally less mysterious than the English terms:

*Balance sheet:* 'statement of condition'.  
*Debtors:* 'accounts receivable'.  
*Trading account:* 'operating statement'.

*Creditors:* 'accounts payable'.  
*Depreciation:* 'value reduction'.  
*Reserves:* 'retained earnings'.  
*Assets:* 'uses' or 'what the business owns'.  
*Liabilities:* 'sources'.

5. Explain that participants will now produce accounts for several real businesses, starting with some of their own enterprise experience businesses. Ask if any of them are familiar with moving picture film, which is made up of large numbers of 'still' pictures which when run together produce the moving pictures we see at a cinema.

Sketch a strip of film on the board, and ask what an individual 'still' shows; it is a picture of the scene at one instant of time, which we can study at leisure to see all the details.

Ask what the film shows when it is run together; we lose the individual detail, but we can see what happens over a period of time.

Can participants relate this to financial accounts? Explain that the 'balance sheet' or statement of condition is like a single 'still'; it shows the financial position at a moment of time. Accountants usually produce these statements at the end of a financial year, but we can, and indeed will, produce them for any moment in the life of a business.

A trading or profit and loss account, or as we shall call it an operating statement, is like a movie; it shows what has happened over a period, which may be a year but may also be a month, a week or a day. The period should be chosen according to the nature of the business and the use for which the statement is intended, not because of any accounting conventions.

6. Identify a participant who is running her enterprise experience on her own, who has not taken a 'bank' loan for it, and, if possible, has no previous knowledge of accounting.

Ask her to describe the financial position of her enterprise, at the moment (which may be now), when she had already put some of her money into it but had not yet spent any of the money. From the point of view of the business, what was the source of its money and in what form is it now owned by the business?

Do not allow participants who are familiar with accounts to answer; elicit the following answers and write the 'statement of condition' of the participant's business on the board as follows, of course using the correct figure:

Uses (\$)		Sources (\$)	
Cash	10	The owner	10

Ask a participant who does know something of accounts to say what this statement is. It is a *balance sheet* for the business at that moment. Stress that the words, the layout and the sequence which are used are unimportant, and professional accountants in fact use many different layouts according to the way they were trained.

What matters is that every participant understands what the figures mean.

7. Ask a partner in another enterprise experience, preferably one which has more than one owner and which has already bought or received from the owners some equipment or materials, so that it owns something in addition to cash, to do the same for his business.

As before, do not allow participants with accounting knowledge to answer, and elicit the figures in the following form (the following figures might be for a laundry business):

Uses (\$)		Sources (\$)	
Cash	5	Owner A, cash	10
Soap powder	4	Owner B, bowl	10
Washing bowl	10		
Notebook	1		
<b>Total</b>	<b>20</b>	<b>Total</b>	<b>20</b>

Explain that this statement is called a 'balance sheet' because the total figures 'balance', that is, they are the same. There is no mystery in this, since the two columns are merely giving different information about the same sum of money; how it is being used in the business and where it came from.

8. Ask another participant who presented a simple and reasonable forecast of the results of his enterprise experience business to repeat the figures. Write them on the board in the following form:

		\$
Sales <i>less</i>		100
Cost of items		70
<b>Difference <i>less</i></b>		<b>30</b>
Expenses:		
Poster	2	
Wages	18	
Total expenses		20
<b>Profit</b>		<b>10</b>

As before, ask a participant with accounting experience to say what this statement is. It is a *profit and loss account* or *statement of operations*, or rather, a forecast of such a statement for a certain, specified period.

As with the statement of condition, stress that the details of the layout are not important. It is not always necessary to show the margin between the sales revenue and the cost of what was sold, for instance, particularly when the business is a laundry, a barber, a rickshaw or other service business where little or no materials are consumed directly for each sale.

In trading businesses, however, where the main expense is the goods which are bought and sold, this margin is obviously an important figure. Participants may be more familiar with the phrase 'gross profit'. Here again, stress that the words are not important; what matters is the use to which the figures will be put.

9. Refer back to the simple statement of condition or balance sheet produced in item 7 above. In this example, the things owned by the business included materials (the washing powder in our example) and equipment (the bowl). Ask participants what other ways there are in which money can be owned by a business, apart from cash, materials and equipment?

Elicit answers such as the following; as before, do not allow accountants to answer, and elicit any items that may have been omitted by asking questions rather than merely giving the missing item yourself:

- Bank balances
- Money owed by customers for goods taken on credit (the right to receive the money in the future, as represented perhaps by an IOU, is something that can be owned. Point out that cheques, and even bank notes, are really the same thing)
- Partly finished goods
- Buildings
- Advance payments (some businesses have to pay in advance for rent, electricity or other services; if they have not yet 'used up' what they have paid for, the right to use it is something that the business owns)

10. Refer again to the same simple statement of condition, but to the 'sources' side. The two owners were the only sources of money for this business. Ask participants what other sources of money there are.

As before, elicit a list that includes the following items:

- Bank loans
- Money owed to suppliers for supplies taken on credit.
- Advance deposits from customers (these are the same as loans, since the business owes the customer the money until the product has been delivered)
- Profits that have not been taken out by the owners, but have been retained in the business

Participants may suggest sales as a source of money; they are of course right, in that sales revenue is the main way in which a business gets money, once it has started operations.

Stress, however, that the 'still' picture only includes what is in the business at that moment of time; the money indeed came in from sales, but most of it probably went out in the form of labour, materials and so on. The still picture only includes what remains, if anything, which is that part of the profits that has not been withdrawn by the owner(s).

11. Ask participants each to recall a very small business owned by one of their clients or somebody with whom they are very familiar, preferably a simple trading business such as a fruit or vegetable vendor.

Choose one participant; ask her first briefly to describe the business she has recalled, without mentioning figures. Then ask the other participants in turn each to ask her for one figure; draw up a layout and write the figures she gives in answer on the board as the participant who asked the question directs you.

The business for which the figures are being obtained probably has no written records; ask the participant who is familiar with it to make the best guesses she can, and to admit that she has no idea when that is the case.

Go round the class until every relevant figure has been requested; ensure that participants remember to ask whether the business sells or buys on credit, whether it has a bank account, whether any customers pay in advance, and so on. They will be repeating this exercise later in the course in the field, with real businesses, and they will only be able to get complete information if they remember to ask for every item.

12. Very few of the owners of the sort of businesses with which we are dealing know how much profit (or loss) they are making, and even fewer make a conscious decision to withdraw, or leave in the business, a certain proportion of the profits. If participants have asked how much money the owner has reinvested in the business from the profits, the participant who is familiar with the business is most unlikely to have been able to give an answer.

The total figures for what the way money is being used and the sources are therefore unlikely to balance. Ask participants to explain the difference, and if necessary write on the board some hypothetical figures such as the following:

Uses (\$)		Sources (\$)	
Cash	15	Owner A, cash	10
Soap powder	4	Owner B, bowl	10
Washing bowl	10	Loan from bank	5
Notebook	1		
Owed by customer	5		
<b>Total</b>	<b>35</b>	<b>Total</b>	<b>25</b>

Elicit the answer that if the figures for the ways in which money is being used and the sources are complete and correct, the only possible source of the difference is retained earnings; the owners have, probably without being aware of it, left \$10 in the business from its profits.

The corrected statement of condition should therefore read:

Uses (\$)		Sources (\$)	
Cash	15	Owner A, cash	10
Soap powder	4	Owner B, bowl	10
Washing bowl	10	Loan from bank	5
Notebook	1	Retained profits	10
Owed by customer	5		
<b>Total</b>	<b>35</b>	<b>Total</b>	<b>35</b>

13. Amend the figures so that the total of 'uses' is less than the total of the 'sources', as in the following example. Ask participants to explain what is missing in such a case:

Uses (\$)		Sources (\$)	
Cash	15	Owner A, cash	10
Soap powder	4	Owner B, bowl	10
Washing bowl	10	Loan from bank	20
Notebook	1		
<b>Total</b>	<b>30</b>	<b>Total</b>	<b>40</b>

In this case, more money has come into the business from the sources than is represented by the ways in which it is now being used. As in the previous example, if the figures are complete and correct, the only explanation is that the business has lost money; the statement of condition should be corrected as follows:

Uses (\$)		Sources (\$)	
Cash	15	Owner A, cash	10
Soap powder	4	Owner B, bowl	10
Washing bowl	10	Loan from bank	20
Notebook	1	<i>less losses</i>	(10)
<b>Total</b>	<b>30</b>	<b>Total</b>	<b>30</b>

Participants may find it clearer to add the amount of losses to the uses side, rather than subtracting it from the sources; either is correct, what is important is that they should understand the principle.

14. Ensure that at this and every stage all participants, and not only those who have already had accounting experience, understand each stage.

Many of the concepts are difficult to grasp at first, and a great deal has been covered in this session; ask those participants who do understand further to develop their understanding, and, what is even more important for field workers, their ability to share their understanding, by explaining difficult points to those who have difficulty.

This provides an opportunity for you, the instructor, to demonstrate your commitment to mutual learning and your commitment to full participation. Encourage participants themselves to try to explain to the others points that you yourself have failed to put across, and stress that you are all learning practical accounting and the far more difficult and important skills of communicating with your colleagues and your clients.