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1.
What are financial statements and why do I need to use them?

The Basics

Financial Statements are documents to help you run your business and are a formal record of your business' financial activities. As you are putting your time, work, and money into your business, you want to be sure that you are making the money you need to support your family and to grow your business.

There are three very important financial statements that you should look at each month: the Income Statement (also known as a Profit and Loss statement or P&L), the Balance Sheet, and the Cash Flow Statement. There are other statements that you might use as your business grows, but these statements are the three most commonly used documents.

The Income Statement shows if your business is making money or losing money. The Balance Sheet shows how much money you have in your business and how much money you owe to other people. The Cash Flow Statement records when money comes into and goes out of your business.

You should review and update these statements every month and keep them private and confidential. They can help you see when you need to cut expenses, whether you are making a profit, how to plan for changes in your business operations and how successful you are. You will get the information for these statements from bookkeeping records which are lists of income and expenses written down in a journal every day.

Tell Me More

The Income Statement (Profit and Loss or P&L) shows how your business has operated in the past. It is made up of two main parts: revenue (the money that comes into your business) and expenses (the money your business uses). By comparing the revenue and the expenses, you will be able to see if your business is making money (a profit) or is losing money. The difference between revenue minus expenses is called profit. Income Statements report on your business performance over a set period of time such as a specific month, a quarter, or a year.

The Balance Sheet shows what a company owns, what it owes to others, and the value of the business to the owner. It has three parts: assets, liabilities, and shareholder's equity (the value). The reason it's called a balance sheet is because the asset side of the document always equals the liabilities and shareholder's equity side. Where the Income Statement showed a company's performance in the past, the Balance Sheet shows the company's state over one particular point of time (how the company is doing right now).

The Cash Flow Statement shows the money that is flowing into your business and the money flowing out of your business. This document lets you know how much cash you have on hand and if you have enough money to operate your business. This is very useful if you have a business that has busier or less busy times. It can help you plan for paying for your expenses.

It is important to keep these statements up to date and accurate. When your business is small, you will be able to create these statements yourself. As your company grows, you may hire someone to prepare the statements for you. Even if someone else is preparing your financial statements, you should always check them over yourself and know how to read them. It is important you understand the financial statements so that you can apply lessons learned from the information given. These statements are the tools that will help you see if your business is healthy or not.

There are times when you will want to let other people see your statements. You may want advice from an accountant or someone who can help you make good business decisions. They are also very important if you want to get a loan from a bank or other lender. They will want to see that you have a profit and how you manage your business. Lastly, the financial statements information is very important if you want to sell your business or have others invest in it.

Glossary Terms from this Section

Financial Statements - Formal records of the financial activities of a business that includes a balance sheet, income statement, and cash flow statement.

Assets – Anything of value that your business owns.

Balance Sheet – A financial document that shows how much you have in your business and how much you owe at a given time.

Bookkeeping Records – Financial transactions of income and expenses recorded daily or very often.

Cash Flow Statement – A financial document showing the money that is flowing into your business and the money flowing out of your business.

Income Statement – A financial document showing the difference in revenue (income) and expenses.

Liabilities – Anything that your business owes to others.

Profit – Any positive amount of money left over after subtracting expenses from revenue (income).

Shareholder's Equity - The value of a company, or the amount that would be returned to shareholders if all the company›s assets were liquidated and all its debts repaid.

For More Information Related to this Topic See:

- What are Income Statements (Profit and Loss Statements) and how do I use them? *12. Financial Management*
- Where can I get help to create and maintain my financial statements? 12. *Financial Management*
- What is a cash flow statement? *12. Financial Management*
- What are assets? *12. Financial Management*
- What are liabilities? *12. Financial Management*
- Why do I need a balance sheet and how do I create one? *12. Financial Management*
- What is profit, how do I determine mine, and what is my goal? *12. Financial Management*

Additional Tools Available

Balance Sheet

Cash Flow Statement

Income Statement

T-Table Income Statement

2.
What are Income Statements (Profit and Loss Statements) and how do I use them?

The Basics

The Income Statement (Profit and Loss or P&L) shows how your business has operated in the past. It is made up of two main parts: revenue (the money that comes into your business) and expenses (the money your business uses). By comparing the revenue and the expenses, you will be able to see if your business is making money (a profit) or is losing money. Income Statements report on your business performance over a set period of time such as a specific month, a quarter, or a year.

The purpose of the income statement is to show managers and investors whether the company made or lost money during the period being reported. This can be helpful in looking at the past performance of your company, and can be used to more accurately predict future performance.

It is very important that you pay only business expenses from your business account. Your business is viewed separately than yourself as an individual. It is important to show a profit if you want to take out a loan or even sell your business one day as no one will likely invest in a business that is not making money.

Tell Me More

For the most accurate information, an Income Statement should be created each month to help better manage your business and give an accurate account of what money is coming in and how much and where money is being used by your business.

It may seem like a lot of work to keep track of your revenue and expenses, but a Profit and Loss Statement is an important tool that will help you manage your business. In a way, tracking your income and expenses is like taking the temperature of a sick child – the thermometer tells you when there is a health issue so you can address the problem. Similarly, a Profit and Loss Statement lets you "take the temperature" of your business so you can determine whether or not you need to make a change in how you are running your company.

The following is a step-by-step guide on the most common elements in creating an income statement.

How do I set up a Profit and Loss Statement?

Step 1: Set up a worksheet with lines across and two to three columns. This can be done by hand, using software such as excel, or allowing an accounting professional create the statements for you. The third column can be added that shows the income, expenses and profit for the year to date.

As an example, look at Fatima's Beauty Salon. Fatima, age 32, has owned the shop for four years. She employs three hairdressers and one manicurist. Fatima manages the business and is the salesperson for the products they sell.

Here is a sample of her P&L Statement:

Step 2: In the first column, list places money is coming from (income) on top and where it is going (expenses) below. Year to date (YTD) is the sum of all previous months thus far in the year. In this chart, Fatima has earned 39,337 AFN in Sawr and she has earned 78,674 since the start of the year in Hamal.

Income	Sawr (Afn)	YTD (AFN)
Beauty Services	39,337	78,674
Sales of Products	23,528	46,516
Loans	6,800	13,600
Total Income	69,665	139,330
Expenses		
Rent	3,525	7,050
Water	680	1,360
Electricity	1,500	3,000
Generator Fuel	10	10
Payroll	13,600	27,200
Beauty Service Supplies	5,000	10,000
Products to sell	6,800	13,600
Taxes	680	1,360
Marketing	1,700	1,700
Miscellaneous	500	1,000
Cleaning and Repair	2,100	4,200
Repayment of Loan	7,140*	14,280*
Capital Expenses	6,800	6,800
Total Expenses	**51,695**	**94,910**
Net Profit	**17,970**	**44,420**

Step 3: In the second column input the numbers for each category of the income and expenses. These numbers come from your bookkeeping records.

NET PROFIT: (subtracting all expenses total, including capital and repayment of loan from the income total).

Profit for February = 69,665 – 51,695 = 17,970 AFN

Step 4: In the third column, add the income and expenses including earlier months. This gives you the year to date (YTD).

Note that there were no capital expenses in an earlier month. So capital expenses remains at 6,800 AFN.
*Payment of loan includes 5% interest.

Step 5: With a completed profit and loss statement, what can be learned from it?

By using the profit and loss statement (P&L), you can see where your business is making or losing money and what times of the year are better. Some months there will be less income than expenses (loss) and some

months the income will be greater than expenses (profit). In February, Fatima makes a net profit of 17,970 AFN, but in other months, she may lose money in the form of a loss.
To plan for the months that have a loss, you may do some special marketing, like special prices on certain services or parties to bring in more customers. (See the marketing section)

It is very important to save a good amount of cash, perhaps from the net profit for each month, in the bank so that you can pay expenses in the months where income isn't enough. You also want to keep money for future improvements.

Glossary Terms from this Section

Bookkeeping Records – Financial transactions of income and expenses recorded daily or very often.

Capital Expense – Large expenses such as property, buildings, or equipment (furniture, tools, and improvements).

Expenses – Money paid out of the business to pay for an item or service.

Income – All the money that comes into your business from sales, service or loans.

Income Statement – A financial document showing the difference in revenue (income) and expenses.

Investors – An individual or company who gives money with the expectation of financial return.

Payroll – Total money paid to workers, self or others.

Profit – Any positive amount of money left over after subtracting expenses from revenue (income).

Revenue – Money coming into the business usually from sales of goods or services.

For More Information Related to this Topic See:

- What are financial statements and why do I need to use them? *12. Financial Management*
- Where can I get help to create and maintain my financial statements? *12. Financial Management*
- What is revenue and how do I know mine? *12. Financial Management*
- What is profit, how do I determine mine, and what is my goal? *12. Financial Management*
- How can I use a Profit and Loss statement to learn which part of my business is more profitable? *12. Financial Management*

Additional Tools Available

Income Statement

T-Table Income Statement

3.
What is a Cash Flow Statement?

The Basics

The Cash Flow Statement shows the money that is flowing into your business and the money flowing out of your business at a single point in time. This document lets you know how much cash you have on hand and if you have enough money to operate your business. This is very useful if you have a business that has busier or less busy times. It can help you plan for paying for the expenses of your business and can help determine whether there is enough cash flow to cover upcoming expenses like payroll.

A cash flow statement helps business owners and investors understand how a company›s processes are running, where its money is coming from, and how its money is being spent. Having a good cash flow and tracking your cash flow is crucial to keeping your business up and running and can allow you to pay off debt and expand your business.

For example, Aziza almost had to close her clothing business due to a cash flow constraint before Eid. She was expecting a payment from a major buyer the month before Eid but her buyer could not pay the money in time. Aziza was not tracking her cash flow in the previous months and did not know how much cash she would need for purchasing fabrics, paying her tailors, etc. She received many orders before Eid and needed to build her inventory, but she didn't have enough cash on hand. She got lucky by receiving a small loan from her brother, otherwise, she wouldn't be able to pay her expenses and potentially close her business. She learned a lesson the hard way and now operates with a good cash flow tracking system.

Tell Me More

The Cash Flow Statement shows the money that is flowing into your business and the money flowing out of your business at a single point in time and helps business owners and investors understand how a company›s operations are running, where its money is coming from, and how its money is being spent.

To create a cash flow statement, you will look at the cash receipts that came in for a given month. The amount of cash paid to you for each sale will be recorded in a journal and listed on a ledger within your bookkeeping records. Next, you will list all the expenses you paid for that month. This information, also, will be in your bookkeeping records. Lastly, you deduct the cash expenses from the cash that came in. This will tell you how much is left in your checking or current account to pay the current month's bills.

Here is an example:
Malalai has a shop that makes and sells souvenirs. The past month was very busy. Three months ago, she received a loan to buy equipment. Now she is paying it off.

Step 1: List the income received from sales during the past month.

Income:

Sales and service:	39,337

Step 2: List all the cash expenses for the month.
Cash Expenses:

Payroll (including your salary)	(10,200)
Rent	(2,675)
Materials	(800)

Taxes	(700)
Electricity	(500)
Loan Payment	(1,000)
Total Expense	(15,875)

Step 3: Deduct Total Expenses from Income to get Net Cash Flow.

Net Cash Flow	23,462

The amount of cash left at the end of the month is the Net Cash Flows. This has been a good month for Malalai. Her monthly expenses, including repayment your loan were 15,875 and she has cash of 23,462 left in her checking account.

This was a good month but next month may bring in less income due to the upcoming end of the busy Eid celebrations. However, rent, payroll, taxes, and electricity expenses will continue as before since the tourist season has no effect on the amounts.

What is a cash reserve?
The cash reserve is the amount of money you should keep in the bank for business expenses in the event that your business does not make enough money to cover its expenses for a period of time. In Malalai's case, the money she has left over after the current month's expenses should remain in her checking account (also called a current account) to pay for expenses she has when her cash coming in doesn't cover the expenses for that month. It is commonly advised that cash reserves should equal three to six months of typical monthly expenses.

Glossary Terms from this Section

Debt – Money borrowed by one party from another often a loan from a bank.

Expenses – Money paid out of the business to pay for an item or service.

Journal – A detailed account that records all the financial transactions of a business.

Ledger – A ledger is a complete record of financial transactions over the life of a company.

Revenue – Money coming into the business usually from sales of goods or services.

For More Information Related to this Topic See:

- What are financial statements and why do I need to use them? *12. Financial Management*
- Where can I get help to create and maintain my financial statements? *12. Financial Management*
- What is revenue and how do I know mine? *12. Financial Management*
- What are the best ways to handle transactions including cash payments? *12. Financial Management*
- What is a ledger? *11. Bookkeeping*
- How does bookkeeping help financial management? *11. Bookkeeping*

Additional Tools Available

Cash Flow Statement

4.
What are assets?

The Basics

Assets are anything of value that your business owns. They are possessions of your business that will bring benefits to your business in the future. Assets can be tangible (physical items such as cash, inventory, employees, materials, equipment, or property) or intangible assets (non-physical items such as a website, software, relationships, or patents).

Assets like cash, supplies, equipment and others allow you to buy what you need, make the things that you sell, or provide people the services needed for your business to make a profit.

Having valuable assets also makes it possible for you to get a loan or credit (trust from someone who will lend you money and knows you will pay them back later at a later date). Banks, investors, and people are more likely to lend your business money to grow when they know you have things of value to back up your promise to pay them back.

Tell Me More

There are several kinds of assets in business. Tangible assets are physical items such as cash, equipment, tools, buildings, land, inventory, materials, cell phones, furniture, computers, vehicles, employees, and money owed to you. Intangible assets are non-physical items such as a website, patents, trademarks, brands, software, or relationships.

Tangible Assets		Intangible Assets
Cash	Materials	Website
Equipment and Tools	Employees	Patent
Buildings	Furniture	Trademark
Land	Computer	Brand
Inventory	Vehicle	Software
Phone	Money Owed To You	Relationships

Assets also fall into two categories from the perspective of how quickly you can use them or turn them into cash:

Current Assets – Those assets that will be used up in a year or less and easily sold for cash.

- Cash
- Checking, Current, or Savings Account
- Inventory
- Supplies
- Accounts Receivable (money you will collect from customers)

Long-term (Fixed) Assets – The assets you will use for a long time, greater than one year, and cannot be easily sold for cash.

- Equipment
- Furniture

- Building
- Vehicles

Assets are shown on the Balance Sheet as part of your financial reports. The Balance Sheet shows what a company owns, what it owes to others, and the value of the business to the owner. It has three parts: assets, liabilities, and shareholder's equity (the value). Examining an organization's balance sheet shows its financial strength, and whether it can meet its financial responsibilities.

How do you find the value of an asset?

- The value of current assets can be determined by looking at what you paid for the asset. It can be the amount of cash on hand, or in a bank account, the price you paid recently for supplies or inventory, or the knowledge of what something is worth right now.

- The historical cost of an asset is the original price paid at the time of purchase. The market value of an asset is the price at which you could sell the asset at right now.

- For accounts receivable, you know how much money you have billed your customers (or asked for). This is how much money you are expecting to receive from your customers.

- The value of long-term assets can be determined by seeing what these things are selling for right now. The value is the price you could get for them now if sold, not what you initially paid for them. The best way to find this out is to go to markets or other places that sell the item, and ask to find their current prices. Long-term assets depreciate (lose value) over time.

Glossary Terms from this Section

Accounts Receivable – Money expected from your customers.

Assets - Anything of value that your business owns.

Balance Sheet – A financial document that shows how much you have in your business and how much you owe at a given time.

Liabilities – Anything that your business owes to others.

Patent – A government license that gives the holder exclusive rights to a process, design or new invention for a period of time.

Shareholder's Equity - The value of a company, or the amount that would be returned to shareholders if all the company›s assets were liquidated and all its debts repaid.

Trademark – A familiar sign, symbol, or phrase that indicates a product or service and legally sets it apart from all other products.

For More Information Related to this Topic See:

- What are financial statements and why do I need to use them? *12. Financial Management*
- What are assets? *12. Financial Management*
- What are liabilities? *12. Financial Management*
- Why do I need a balance sheet and how do I create one? *12. Financial Management*
- What are accounts payable and accounts receivable? *10. Bookkeeping*

Additional Tools Available

Balance Sheet

5.
What are liabilities?

The Basics

Liabilities are anything that your business owes to others. It is typically an amount owed to a supplier, bank, lender, or other provider of goods or services. To settle a liability, you must pay cash, provide a service, or asset. Examples of liabilities may include, employee wages to be paid, loans and interest, income taxes, and goods or services received that are not yet paid. If you run a wood carving business where you produce wood-carving pieces for decoration of homes and organizations, you often need quality wood for your products. When you receive the wood from your supplier and commit to pay a few months later, you basically increase your liabilities.

Tell Me More

Every business is made up of:

- **Assets –** what the business owns.
- **Liabilities –** what the company owes to others.
- **Equity –** the part of the company assets that the owner owns.

It is very important to know what are your liabilities (what is owed) and how to manage them.

There are two kinds of liabilities:

Current liabilities: Bills to be paid within the year. This will include payments to vendors (people you buy from), contractors (who may do work for you), and loan payments that are due in the year.

Long-term liabilities: Debt (what you owe) longer than a year. This includes things like long-term loans or mortgages if you have bought your building.

An important way to manage your liabilities is reviewing how you are operating your business and look for ways to lower your expenses. A way to manage your current liabilities is to look for places that charge less for supplies and services so that your payments to vendors are lower. A way to manage your long-term liabilities is by paying your loans and debts on time or early so that you limit the additional interest added to your debt.

Liabilities are recorded on your balance sheet which shows the current financial state of your business. Payments to vendors are recorded as Accounts Payable. The amount of your liabilities is important in deciding if your business is making a profit. Knowing the amount of the liability will help you decide whether you would be able to repay a loan. If your loan debt is greater than your income, your organization may have trouble staying in business.

When seeking a loan or wanting to sell your business, the lender or buyer will want to know the amount of your liabilities to determine the health and value of your business.

The best way to track your liabilities is to review the amounts you owe to others periodically, i.e. every month, and make arrangements accordingly. You can manually add your payables or ask you book keeper to give you an account of liabilities for each period. As a smart business person, you should always keep an eye on your liabilities and ensure you are not surprised by a due payment you didn't expect to pay yet.

Glossary Terms from this Section

Accounts Payable – Money owed by a company to its creditors.

Assets – Anything of value that your business owns.

Balance Sheet – A financial document that shows how much you have in your business and how much you owe at a given time.

Debt – Money owned to another.

Equity – The company assets that the owner owns.

Liabilities - Anything that your business owes to others.

Mortgage – A legal agreement by a bank or other creditor that lends money to buy property and isn›t owned until the loan amount is paid back.

For More Information Related to this Topic See:

- What are assets? *12. Financial Management*
- Why do I need a balance sheet and how do I create one? *12. Financial Management*
- How do I account for equity? *12. Bookkeeping*
- What are accounts payable and accounts receivable? *12. Bookkeeping*

Additional Tools Available

Balance Sheet

6.
Why do I need a balance sheet and how do I create one?

The Basics

A balance sheet is a financial document that shows how much your business owns and how much it owes at a given time. It also shows what you've personally invested in your business. It is a picture of the company's value at a given moment.

Things your business owns (like its checking or current account) are called "Assets". What your business owes (like bank or family loans) are called "Liabilities". Your investment in the business is called "Equity".

A balance sheet is one of the financial statements that an investor or bank may ask to see to determine whether the loan is a safe investment. The statement that tracks these things is called a Balance Sheet because it balances.

In other words: Assets = Liabilities + Equity

A Balance Sheet is important because it gives a picture of your business at a specific point in time. You can use it to compare what you own (your Assets) to what you owe (your Liabilities). It helps you to understand the stability of your business. Can your business survive if there is a short down turn in the business? This is also important in deciding if the business is worth continuing.

Tell Me More

What is included in a balance sheet?

Assets are divided into four categories:
- Current Assets: cash available (in the bank), accounts receivable (money you expect to come to you in the near term).
- Long Term Assets: equipment, furniture, property or building that you own. Also, items that have a value for a long time (such as vehicles or equipment).
- Inventory: Items that the business has that have sale value.

Liabilities are divided into two categories:
- Current liabilities: bills that need to be paid in the next 12 months
- Long-term liabilities: debts that are paid over a longer term such as mortgages, long-term loans

Owners' Equity (also called capital) is the amount of money put in by the owners to start the business.

- Retained Earnings: profit that has been drawn out and reinvested in the business.
- Dividends: a portion of a company's earnings given to shareholders.

How do I set up a balance sheet?

Step 1: Set up a sheet, either paper or electronically such as Excel, with the company name, title of "Balance Sheet" and Date. (See the tools section for a balance sheet template)

Step 2: List current and long-term assets by category and the monetary value of each. For example:
- Cash in the register or at the store at the end of the day
- Checking, Current, or Savings Account

- Inventory
- Equipment
- Furniture

Step 3: List the current and long-term liabilities by category and the monetary value of each. For example:
- Accounts Payable
- Payroll
- Rent
- Loans

Step 4: Add all assets together. Add all liabilities and equity together. The total assets should equal the same amount as the total of liabilities and owner's equity. Assets = Liabilities + Equity

See Sample:

Balance Sheet – May 31, 2017	
ASSETS	
Current Assets:	
Savings Bank	25,000
Checking/Current Account	5,500
Inventory	10,000
Total Current Assets	40,500
Long Term Assets:	
Equipment	15,000
Furniture	8,000
Total Long Term Assets	23,000
Total Assets	63,500
LIABILITIES	
Current Liabilities:	
Accounts payable	5,000
Payroll	8000
Rent	500
Long-Term Liabilities:	
Loans	25,000
Total Liability	38,500
OWNERS EQUITY	
Owner's Investment	25,000
Total Liability and Owner's Equity	63,500

Glossary Terms from this Section

Accounts Payable – Money owed by a company to its creditors.

Accounts Receivable – Money expected from your customers.

Checking Account (Current Account) - An agreement with a bank that allows money to be put into the account and the writing of checks to pay for expenses.

Current Assets – Those assets that will be used up in a year or less and easily sold for cash.

Current Liabilities – Anything owed that needs to be paid in less than a year.

Equity - The company assets that the owner owns.

Long-term (Fixed) Assets – The assets you will use for a long time, greater than one year, and cannot be easily sold for cash.

Long-term Liabilities – Anything owed that needs to be paid in more than a year.

Mortgage – A legal agreement by a bank or other creditor that lends money to buy property and isn›t owned until the loan amount is paid back.

Payroll – Total money paid to workers, self or others.

For More Information Related to this Topic See:

- What are financial statements and why do I need to use them? *12. Financial Management*
- What are assets? *12. Financial Management*
- What are liabilities? *12. Financial Management*
- Where can I get help to create and maintain my financial statements? *12. Financial Management*
- What is a checking account and how do I use it? *12. Financial Management*
- How do I account for equity? *11. Bookkeeping*
- What are accounts payable and accounts receivable? *11. Bookkeeping*
- How is my budget different from my financial statements? *12. Financial Management*

Additional Tools Available

Balance Sheet

7.
Where can I get help to create and maintain my financial statements?

The Basics

It is important to track and show the health of your business and how it's doing over time. A key way to track this and be able to show others is through financial statements. Financial Statements are documents to help you run your business and are a formal record of your business' financial activities.

There are three very important financial statements that you should create and review each month: the Income Statement (also known as a Profit and Loss statement or P&L), the Balance Sheet, and the Cash Flow Statement.

The Afghan government has specific templates (usually in hard copy form) for businesses to report their financials. These templates can be received in person at the tax offices or on the internet at the Ministry of Finance website. Proper financial statements based on daily records of journal and ledger entries help to provide accurate reports to the government on monthly, quarterly, and annual basis.

Depending on your skill, past knowledge, and level of comfort, you may need to ask others to assist you in creating and maintaining these financial statements. Accountants can take the daily financial information from your ledger (a complete record of financial transactions) or journal and create the statements for you. Bookkeepers can help you set up a ledger, or journal to keep a record of your daily financial activities. Software programs such as QuickBooks or Microsoft Excel are other tools to help you record and create financial statements. Sometimes, groups of business owners may also share with and help each other create and better understand the financial statement information together. Lastly, one of the best and often easiest ways to get help creating and understanding your financial statements is to visit and talk directly with other business owners who can share their experience and knowledge with you.

Tell Me More

There are many resources available to get assistance in creating and understanding financial statements. Creating and understanding financial statements is vital in understanding and showing the health of your business.

Accountants set up the way you will create your statements that will help you manage your business finances. They will guide you in creating your Income Statements, Balance Sheets, Cash Flow Statement, and financial plans to grow, your assets and manage your liabilities. Accounting & taxation service providers help you develop an accounting system, train your staff, and create your financial statements. You can ask for one-time support or outsource your accounting work to them against a fair fee.

Bookkeepers are people who set up all the records for keeping track of your daily financial activities. They can give you the tools like journals and ledgers, where you write down every exchange of money, whether it's money coming in from sales or loans, and where money is being used by your business. This is the information that accountant use to create financial statements. If you have access to a computer, there are software programs that help you set up financial records and manage them yourself. Microsoft Excel and QuickBooks are among the most popular to use.

Sometimes cooperatives of businesses, business owners who come together to share information and ideas, or chambers of commerce in your area, help each other create and better understand financial management tools. They often have a good understanding of your business and can offer advice. They may also bring in an expert to help all of the members of the group. For example, the Afghanistan Chamber of Commerce & Industry (ACCI) helps its members identify service providers and can share a list of companies that offer financial services.

Some Non-Government Organizations (NGOs) or donor organizations will offer training for new business owners as part of their community development programs or send an expert to help you create your financial statements.

Banks or other lenders can help you specifically learn about managing interest rates and loans. Another good resource are other friends, familial networks, or fellow business owners whom you can talk to directly for advice and assistance in creating and better understanding your financial statements.

Glossary Terms from this Section

Accountants – Someone whose job is to keep the financial records of a business or person.

Balance Sheet – A financial document that shows how much you have in your business and how much you owe at a given time.

Bookkeepers – People who set up and work on all the records for keeping track of daily financial activities.

Cash Flow Statement – A financial document showing the money that is flowing into your business and the money flowing out of your business.

Income Statement – A financial document showing the difference in revenue (income) and expenses.

For More Information Related to this Topic See:

- What are financial statements and why do I need to use them? *12. Financial Management*
- What are Income Statements (Profit and Loss Statements) and how do I use them? *12. Financial Management*
- What is a cash flow statement? *12. Financial Management*
- Why do I need a balance sheet and how do I create one? *12. Financial Management*
- What is bookkeeping? *11. Bookkeeping*
- What is a ledger? *11. Bookkeeping*

Additional Tools Available

Balance Sheet

Cash Flow Statement

Income Statement

T-Table Income Statement

8.
What is revenue and how do I know mine?

The Basics

Revenue is the money that comes into your business from customers for sales, services, or things you sell that you no longer need for your business. Revenue is also known as sales and is calculated by multiplying the price you sold your product or service by the number of units or amount you sold. Any Interest or fees that you have collected from loans that you have given out is also collected as revenue.

For example, Makiz sells packaged dried fruits in Kandahar province to retail stores. At the beginning of each week, she distributes boxes for packaged dried fruits to retail stores and collects the money in a week time. The money is her revenue when she collects them at the end of each week. Last week Makiz sold 200 boxes of packaged dried fruits and at a price of 800 AFN per box, her revenue summed to 160,000 AFN.

Your revenue amount will go on the top of your income statement where expenses are then deducted from revenue to obtain your net income, or profit. The higher your revenue and the lower your expenses, the more profit you will have to reinvest in your business, or pay yourself more.

Tell Me More

It's important to track your sales and revenue to know how much money is coming into your business. With high revenue and low expenses, your business is healthier and more likely to succeed. Investors will often consider a company›s revenue and profit separately to determine the health of a business.

There are several ways to keep track of revenue. In bookkeeping, revenue is recorded every day or as often as needed by writing down in a journal how much came in, where the money came from and what it was for. This helps to see which part of your business is the busiest and what is selling the best. This is also helpful in planning when to buy the inventory you may need.

Step 1: Record when the sale happened, what product or service it was for, the amount collected. Here is an example:

Date	Where from	Amount	For What
3/2/17	Beauty service	50	Haircut
3/2/17	Sales	15	Face Cream
3/4/17	Beauty service	30	Manicure

Step 2: You can also keep track of revenue by looking at copies of the receipts you have given customers. Here is an example:

Fatima's Beauty Shop Receipt				
Date	Customer	Item Bought	Price	Paid
3/2/17	Malalai Saadat	Haircut	50	50

Step 3: Add together all of the revenue collected and list this total on the top line of your Income Statement P&L. Revenue is not the equivalent of profit. If the costs of generating the revenue is more than the income earned from the sales, then you have lost money instead of making money. All the revenue belongs to the business. You may take your share through your salary. You may also take your share if, at the end of the year, there is enough profit to make a distribution. Distribution is the money given to the owner as a repayment for the money the owner invested in the business or share of the profits.

Glossary Terms from this Section

Bookkeeping Records – Financial transactions of income and expenses recorded daily or very often.

Distribution – Money given to the owner as a repayment for the money the owner invested in the business or share of the profits.

Expenses – Money paid out of the business to pay for an item or service.

Income Statement – A financial document showing the difference in revenue (income) and expenses.

Profit – Any positive amount of money left over after subtracting expenses from revenue (income).

For More Information Related to this Topic See:

- What are Income Statements (Profit and Loss Statements) and how do I use them? *12. Financial Management*
- What is profit, how do I determine mine, and what is my goal? *12. Financial Management*
- How do I record revenue? *11. Bookkeeping*

Additional Tools Available

Income Statement

T-Table Income Statement

9.
What is the difference between operating costs and capital investments?

The Basics

Operating costs, often referred to as "OPEX", are the day-to-day ongoing expenses of running your business such as rent, electricity, salary, supplies, or travel.

Capital investments, often referred to as "CAPEX", are larger expenses that are usually for permanent equipment, patents, or purchases that are not made very often, such as renovation, building, or improvement of property.

It's important to distinguish between the two as it can impact your budget and the use of money. With operating costs, once the money is spent, it is gone. You may have received a benefit from spending the money but you don't end up having a tangible asset that adds value to your business. When purchasing capital investments, even though the money is spent, the asset you now have still has value that can continue to add value to your business because it will be used over a longer time.

For example, Marjan owns a catering business in Herat city. She cooks food at her kitchen and supply to different organizations in the city. When she buys vegetables, pays salaries to the chefs, and pays rent for the business space, she considers these as operating costs. But when she buys a new piece of kitchen equipment such as a long-lasting oven, she makes a capital investment.

Tell Me More

Operating costs or expenses may include rent, payroll, electricity, water, advertising, supplies, and marketing; these expenses necessary to run your business. You cannot run your business without them but you can look into ways to try to reduce these costs. An example would be, reducing the labor time used, purchasing lower cost supplies, or getting rid of unnecessary costs to your business.

Capital investments are for items that will last for a long time or have a long-term impact on the business. These expenses will not occur each month. Capital investment is about assets, things that an organization can tangibly own and keep. When purchasing capital investments, even though the money is spent, the asset you now have still has value that continues to add value to your business and is used over a longer time. Another difference is that a capital investment or asset will depreciate (lose value) over time. In other words, the longer you hold the investment, the less you will be able to sell it for at a later time. For example, if you purchased a car for one price, the amount you could sell it for two years later will be less. So the asset lost value over the two years' time. You will want to think about this concept when buying large purchases and look for assets that will hold their value and be worth more than a comparable asset. Perhaps there are two similarly priced cars but one of the cars is known to be of better quality and will sell for more later on.

Sometimes it is difficult to decide to buy expensive items for your business. It may mean taking a loan or using some of the revenue that you would like to take for yourself. With capital investments, these expensive items can make your work easier or help your business do more. For example, if you are using a lot of labor time to stack large boxes of produce, it may be helpful and more efficient to buy a machine that lifts multiple boxes at one time, instead. It would be easier and potentially cost less than the large amount of labor used. If using manual hand tools, electric tools usually work better, faster, and allow you to make more products to sell. This is an important concept in growing your business and managing our operating costs.

Capital Investments are listed separately from the Operating Expenses on an Income or Profit & Loss Statement.

Glossary Terms from this Section

Assets – Anything of value that your business owns.

Capital Investments (CAPEX) – Purchase or investment in a long-term asset.

Expenses – Money paid out of the business to pay for an item or service.

Income Statement – A financial document showing the difference in revenue (income) and expenses.

Operating Costs (OPEX) – The day-to-day ongoing expenses of running your business.

Patent – A government license that gives the holder exclusive rights to a process, design or new invention for a period of time.

Revenue – Money coming into the business usually from sales of goods or services.

Tangible – Physical items such as cash, inventory, employees, materials, equipment, or property.

For More Information Related to this Topic See:

- What are Income Statements (Profit and Loss Statements) and how do I use them? *12. Financial Management*
- What are assets? *12. Financial Management*
- What is revenue and how do I know mine? *12. Financial Management*
- What are fixed and variable costs? *12. Financial Management*
- How can I manage my costs and expenses? *12. Financial Management*
- How do I plan for spending money for my business? *12. Financial Management*

Additional Tools Available

Income Statement

T-Table Income Statement

10.
What are fixed and variable costs?

The Basics

All costs or expenses an organization has can be broken into two categories: fixed and variable costs.

A fixed cost is the money you spend that does not change depending on the number of products you sell. These remain the same no matter if you sell 0 or 1000 products. These can include things like: rent, repayment of loans, insurance, buildings, and equipment.

A variable cost is the money spent to make and sell your products or provide your services and goes up together with each product sold. Variable costs can include raw materials, inventory, labor, supplies, and shipping costs. These costs can be lowered based on the amount of business, lower cost of supplies to make your product, or time of year.

It is important to distinguish between variable and fixed costs because it helps you make sound business decisions. You may not want to increase your fixed costs unnecessarily and only do so if you know it helps your business grow or produce more efficiently. For example, many businesses in Afghanistan hire labor on daily basis as opposed to hiring full time staff in order to keep fixed costs low and pay for labor only when needed. Make smart decisions to avoid paying any unnecessary costs.

Tell Me More

It is important to know and understand which costs are variable and which are fixed. This will help you plan your expenses and know which costs you have more control over. By knowing your fixed costs, you can plan for how much money you will need to keep the business open. There may be ways to lower the amount of fixed costs such as sharing or moving to a new building space, inventory storage, or reducing the number of employees you have.

You have more control over variable costs as they are directly related to making your product or service. As your sales go up, so do your variable costs. As sales go down, variable costs go down as well. A good way for an organization to save money is to reduce your variable costs by finding a lower cost supplier, reduce labor costs or salaries, delivery charges, or shipping costs.

This is an example of how variable costs can change:

Fatima owns a Beauty Parlor. If she has fewer customers in her shop or if the shop is closed for holidays, Fatima will notice that less electricity and water are used and the bill will be less as a result. But, the more customers she has and more haircuts or nail services provided the more electricity, water, and other beauty supplies she will use. On those days, her variable costs will be higher than if she did not have any or fewer customers.

A way for Fatima to lower her costs would be to have less workers work on days she knows will have fewer customers resulting from bad weather or the holidays, for example. This will lower her payroll costs. She can also try methods to lower her electricity costs such as turning off unneeded lighting, machinery, etc.

Managing variable costs is very important to make a profit. If there is less business, there will be less income. Fatima should keep her shop open and reduce any variable costs so that she can pay the fixed costs and be ready for more business when it comes.

It's equally important to keep your fixed costs low. Paying a large amount of your revenue or cash for fixed costs that may not really help your business is not recommended. You should constantly review your fixed costs and be wary of committing to make monthly payments that could be reduced by paying as you go. For example, you can use on-demand cabs for transportation if you don't need a full-time driver and a rented car to run your business.

Glossary Terms from this Section

Expenses – Money paid out of the business to pay for an item or service.

Inventory – The products you sell that you have on hand.

Profit – Any positive amount of money left over after subtracting expenses from revenue (income).

For More Information Related to this Topic See:

- How can I manage my costs and expenses? *12. Financial Management*
- What does seasonal mean for income and expense in my business? *12. Financial Management*

11.
What is profit and how do I determine it?

The Basics

Profit is the amount of money left over from sales, or revenue, after all costs are paid. Any profit may be spent on the business or kept by the owners. Profit is one of the best measures of success and consistently earning a profit is the goal of every business.

A business' income should be greater than its expenses so that it has the necessary money to pay its bills, invest back into the business to grow, and be able to employ others. As one of the best signs your business is doing well, it is important to track and try to increase the amount of profits you gain. Here is an example of how to determine your profit:

Fatima's Beauty Parlor has brought in 42,969 Afs of income over the past two weeks. Her expenses for those two weeks were 31,721 Afs. Taking her sales minus her expenses, she has 11,248 Afs left over in profit.

42,969 AFN – 31,721 AFN = 11,248 AFN (Profit)

If she doubles that number (or multiply the profit by two more weeks), she can estimate her profit for the entire month at 22,496 Afs if everything goes at the same pace.

Tell Me More

The terms Revenue and Profit are at times misunderstood in the context of small businesses in Afghanistan. You need to know the terms well so you can manage your finances well. Here are a few points to consider:

- Revenue is the amount of Afghanis that you earn by selling your products or services. When you subtract your expenses from revenue, you find your profit.

- Your personal revenue from many sources is different from your business profit or revenue. When you calculate your profit and withdraw that amount from your business, then it adds to your personal revenue. You should not mix personal & business revenue.

Monthly profits can change.

Monthly profits may change due to many factors, some which can be controlled like raising the price of your product, lowering costs, or finding ways to be more efficient. Other factors may be more out of your control such as changes in weather, holidays, supplies being harder to find or more expensive, etc. It is important to look at the trend of your profits over the course of the year and try to identify what factors had an impact on your business. Fatima has a profit in the first two months, but she may have some months when income is lower than expenses. Fatima may have a loss instead of a profit if her expenses are more than her income. By watching her profit, Fatima can better plan when for when the times are good and when the times are bad for her business.

Measuring profits in different ways. It is possible to measure the different parts of Fatima's business to see which are profitable while others are not. Fatima may find that giving haircuts are less expensive and bring in more money while giving nail services have higher costs. With that knowledge she can decide to try and lower the costs to giving nail services, raise her prices, or market her business toward customers who want haircuts as a way to maximize the profits of her business.

What should be my goal for profit?
The main goal is to make profit but there are different ideas on the amount of profits a business should target. Some advisors suggest a good goal is 17%; while others say over 25%. Profit goals may change depending on the industry you are in. Conduct some research to learn what the profit averages are in your industry to better set your own goals, and always try to continue to increase your profits in order to stay competitive against other businesses providing the same products or services.

How do I determine the percentage of the profit I'm making?
Look at the Fatima's Beauty Parlor example; Fatima had 42,969 Afs of income and 31,721 Afs of expenses making her profit 11,248 Afs. By dividing her profit (11,248 Afs) by her income (42,969 Afs), she sees that she is making 26% profit. So for every 100 Afghanis that she brings in, 26 Afghanis of it is profit.

This profit will allow her to invest in her business to grow and help keep it being successful. Profits are typically either invested back into the business, withdrawn for personal use, or given out back to investors if applicable.

Glossary Terms from this Section

Expenses – Money paid out of the business to pay for an item or service.

Income – All the money that comes into your business from sales, service or loans.

Profit – Any positive amount of money left over after subtracting expenses from revenue (income).

Revenue – Money coming into the business usually from sales of goods or services.

For More Information Related to this Topic See:

- What is revenue and how do I know mine? *12. Financial Management*
- What are fixed and variable costs? *12. Financial Management*
- How can I use a Profit and Loss statement to learn which part of my business is more profitable? *12. Financial Management*
- How can I manage my costs and expenses? *12. Financial Management*

Additional Tools Available

Income Statement

T-Table Income Statement

12.
How can I use a Profit and Loss Statement to learn which part of my business is more profitable?

The Basics

An Income Statement, also known as a Profit and Loss Statement, records all of your operating expenses and subtracts it from all of your revenue to find out if you are making money (profit) or losing money (loss). The statement is important to judge the performance of your business and make adjustments to earn even more profit.

Many businesses have more than one product or service offered with various expenses related to each. It is important to determine which product or service returns the most profit so that you can maximize your efforts for that particular product or service.

Using the Income Statement, look at each product or service separately from each other and find the profit of each by taking the money made from the sale of that product, minus the expenses you have paid relating to that product. Compare the different profits of each. The one or two products or services that make the most profit should become your primary focus to spend your time and energy.

Tell Me More

By finding and focusing your efforts on the part of your business that brings in the most profit, you can maximize your overall business profit and success. To determine which part of your business is the most profitable, review your Income Statement and separate out each product or service you provide. Then match the revenue made from that specific product or service and its related expenses. Subtract the total expenses from the total revenue for each product or service to find the profit that it provides to your business.

If one part has more profit than another does, then you want to grow that part. If an area is losing money (loss), you may want to consider stopping that part or make some adjustments such as cutting costs, raising prices, or investing in marketing to gain more sales.

In this example, Fatima provides two services in her beauty parlor business, haircuts and manicures. She wants to determine which area of her business is more profitable. This will help her determine optimal pricing, marketing and management efforts.

Step 1: Fatima looks at where her various expenses of both haircuts and manicures are being used such as how much time she spends, the cost of electricity, supplies, or payroll, etc.

Step 2: She determines that some expenses, such as payroll, rent, electricity, marketing, cleaning, and repair are about 25% for haircuts and 75% for manicures. It may be difficult to figure out exactly how much of these sorts of expenses should be attributed to each product or service, but do your best to estimate it. In this case, Fatima spends about 75% of her time giving manicures so she has decided to attribute 75% of her fixed costs to that service.

Step 3: She creates a Profit and Loss Statement that lists the two areas of the business separately.

INCOME	Sawr Haircuts	YTD Haircuts	Sawr Manicures	YTD Manicures
Revenue	39,337	78,674	23,258	58,921
Loans	0		6,800	13,600
Total Income	39,337	78,674	30,058	72,521
EXPENSES				
Rent	2,675	5,350	850	1,700
Water	680	1,360	0	0
Electricity	1275w	2,550	255	510
Generator Fuel	255	510	85	170
Payroll	10,200	20,400	3,400	6,800
Supplies	5,000	10,000	0	0
Products to sell	0	0	6,800	13,600
Taxes	510	1,020	170	340
Marketing	1,275	1,275	425	425
Miscellaneous	250	500	250	500
Cleaning and Repair	2,550	5,100	850	1,700
Repayment of Loan	0		7,140	14,280
TOTAL EXPENSES	24,670	48,065	20,225	40,025
NET PROFIT	**14,667**	**30,609**	**9,833**	**32,496**

Step 4: She evaluates both haircuts and manicures in February as well as the Year to Date (YTD).
Looking at February alone, Fatima notices that her profit in haircuts is 14,667 Afs while manicures is 9,833 Afs. However, when she compares the profits of each throughout the entire year, she sees that manicures has profits of 32,496 Afs where haircuts only has 30,609 Afs in profit.

Knowing that manicures tend to add more profit over time than haircuts, Fatima may want to adjust her marketing to focus on getting more manicure sales. She may also want to look closer at what expenses she can remove from haircuts that would allow her to gain more profit in return.

Glossary Terms from this Section

Expenses – Money paid out of the business to pay for an item or service.

Payroll – Total money paid to workers, self or others.

Profit – Any positive amount of money left over after subtracting expenses from revenue (income).

Revenue – Money coming into the business usually from sales of goods or services.

For More Information Related to this Topic See:

- What are Income Statements (Profit and Loss Statements) and how do I use them? *12. Financial Management*
- What is revenue and how do I know mine? *12. Financial Management*
- What are fixed and variable costs? *12. Financial Management*
- What is profit, how do I determine mine, and what is my goal? *12. Financial Management*

Additional Tools Available

Income Statement

T-Table Income Statement

13.
What is break even and why do I need to know?

The Basics

Breaking even is the point where the amount of income your business receives is equal to the expenses used. There is no profit and no loss. Any amount of income over that point is profit and can be used to reinvest in your business or pay your own salary.

Finding the breakeven point is useful because it helps you know how much you have to sell or produce to cover your expenses and to make a profit. It's important to initially target and pass the breakeven point especially when first starting a business. Once you begin making profit, you can expand and improve your business according to your business goals.

Tell Me More

Making a profit is one of the highest priorities for new and existing businesses. As the income of a business can vary from month to month, it is important to see at what point your business will break even and then continue to review it regularly to see if that point changes.

To find your breakeven point:

Step 1: Identify the Total Costs/Expenses
Identify the costs and expenses associated with your business per month. This includes rent, equipment, supplies, labor (yourself and employees), utilities, taxes, loans, etc. Add them together to get your total monthly expenses.

Step 2: Finding Break Even Point
Take your total monthly expenses and divided by the price you charge for your product or service. This is the number of units needed to sell per month to break even. Every unit that your business sells beyond that number will make a profit.

This is an example of Raheela's bowl business finding her breakeven point.
Step 1: Raheela totals her expenses for a month.

Clay	3500 Afs
Rent	3200 Afs
Electricity	300 Afs
Tools	800 Afs
Salary	300 Afs
Total Costs:	8000 Afs

Step 2: Finding Break Even
If Raheela sells her bowl for 100 Afs, she would need to sell 80 bowls per month to break even.
Total monthly expenses (8000 Afs) ÷ price of bowls (100 Afs) = 80 bowls need to be sold.

This does not give her any profit. This is break even.

By knowing this information, Raheela has a few options to make a profit. She can:

- reduce her expenses.

- sell more bowls per month.
- raise the price of the bowls she sells.

Understanding the breakeven point is important in planning your business so that you can meet and exceed your goal of making a profit.

Glossary Terms from this Section

Expenses – Money paid out of the business to pay for an item or service.

Income – All the money that comes into your business from sales, service or loans.

Profit – Any positive amount of money left over after subtracting expenses from revenue (income).

For More Information Related to this Topic See:

- How can I use a Profit and Loss statement to learn which part of my business is more profitable? *12. Financial Management*
- How can I manage my costs and expenses? *12. Financial Management*

Additional Tools Available

Break Even Analysis Worksheet

14.
What is credit and debt?

The Basics

Credit is borrowed money that you can use to purchase goods and services when you need them. It is the trust and opportunity to pay at a later date for things you purchase. Credit can be given by anyone who loans money but it can come from larger institutions such as banks and investment companies, or you could receive money from informal sources, such as family. When receiving credit, you agree to pay back the amount you borrowed, and usually a little extra money. This extra money is called interest. The amount of interest is calculated from a predetermined percentage rate of the original amount borrowed and is for a predetermined amount of time.

Debt is what you owe to a person or a funding source that has provided you with money, goods or services before you pay for them. In accounting, this is called a liability.

The general Islamic opinion is that interest in its pure form is not permissible. Throughout Afghanistan and other countries, there are Islamic financing options which provide credit to individuals and businesses based on Islamic laws. This section is intended to provide an understanding of how credit works in general. Some financial organizations in Afghanistan may adhere to Islamic lending rules though. You can find more specific information on Islamic lending and credit over the Internet or through financial institutions with Islamic financing products.

Tell Me More

Credit can be used as an opportunity to manage a business without needing to use all of its cash before earning income. Credit can also be the customer's opportunity to receive the product or service before paying for it. The customer then owes a debt to the business. In accounting, this is called an account receivable.

Credit can be provided by someone you buy merchandise from (supplier or vendor), a bank, micro-finance organization, credit card company or a friend or relative. To be a candidate for credit through a formal financial institution, you must be able to show that you are trustworthy and have paid other debts and have the ability to earn money to pay back the borrowed amount.

How do I establish credit through a formal financial institution?

Step 1: Review your history to be sure you do not owe anyone money that you were not able to pay back. If you do, pay them back as soon as possible. These debts could be reviewed and show that your business is financially trustworthy or not.

Step 2: The creditor (the one giving you credit) is going to want to know some information about you so that they know that you have the ability to pay back the money. The creditor will ask you to complete an application. The application includes personal information (name, address, phone number, etc.), employment history (where you work now, how long you have been working there, and where you worked in the past), how much money you earn now and in the past, any debts you currently have, such as a mortgage, repayment of school tuition or other loans. The creditor will also want to know if you have collateral. Collateral is something of value you own that will be taken if the loan is not paid back. If you do not have any collateral or do not have collateral of high enough value, you may not be approved for credit. They may also ask for references, people who can confirm the information about you is true.

One important piece of information you can provide is your financial statements. Many banks and financial institutions will ask you to provide your historical Balance Sheet, Income Statement, and also Cash Flow Statement. They look at this information to analyze your credit worthiness. As you learned in this section, financial statements are not only useful to you to manage your business but also to external investors and lenders that may extend you credit.

For your business credit, the creditor will ask for the history of your business, your bank and other references.

Step 3: Using the information you provide, the creditor will tell you the maximum amount of credit they are willing to give you, the terms for repayment (time, interest and penalties for late or no payment).

If you are extending credit to your customer, you want to be sure that they can repay. Using a similar application that your customer can fill out is a useful strategy for determining if or how much credit you are willing to allow them.

It is critical that you follow the rules and comply with the terms you have agreed to when borrowing money. If you do not pay or do not pay on time, you can be charged high fees and the possibility of losing your opportunity to receive credit in the future.

One common business reality in Afghanistan is that customers ask for trade credit where they receive your products and wish to pay you back at a future date. Many retailers use this strategy to retain their customers. You may offer trade credit as an additional value to your customers, but make sure you are confident they will pay you back in time. You need to have good bookkeeping system to track your customers who owe you.

Your business may not be ready to receive credit through a bank or other formal financial institutions. It is helpful to know the process so that you can work towards receiving credit from these organizations in the future, when your business grows large enough. If you are unable to get credit through formal financial institutions, informal lending may be an option.

Informal lending is when you do not use formal financial institutions, but rather rely on people and organizations that you know personally. It can provide a way to borrow money in cases of dire need or if you cannot get money through a bank. Your family, friends, fellow businesses, suppliers, partners, and key buyers are a few possible sources of informal lending. A common source of informal borrowing is the Saraye Shahzada, where money lenders and Hawala dealers provide loans based on trust and guarantee of a third person. The process is easy and informal, but you will need to have a personal guarantor that the lenders can trust. Informal borrowing has its pros and cons. It is easy, quick, and cheaper at times, but there is no documentation, which can potentially create disputes in the future. Choose informal borrowing when you can fully trust the lender and intend to repay the loan back in time.

Glossary Terms from this Section

Accounts Receivable – Money expected from your customers.

Interest – Money paid regularly at a specific rate for the opportunity of borrowing money.

Liabilities – Anything that your business owes to others.

Vendors – A person or organization who offers a product or service for sale.

Credit Worthiness – A valuation of the possibility a borrower may not pay his debt obligations.

The trust extended by suppliers to allow customers to buy now and pay later.

For More Information Related to this Topic See:

- What are liabilities? *12. Financial Management*
- What are loans and interest and how do I manage them? *12. Financial Management*
- What are credit cards? *12. Financial Management*
- How do I account for loans? *12. Financial Management*

15.
What is a checking or current account and how do I use it?

The Basics

A checking/current account is a service provided by a bank that allows you to put money into an account that only you or your business can use. The money in the account is available for you to take out and use when needed. You can access your money by writing a check, using a debit card, or setting up an automatic payment plan that takes out money and gives it to another with your permission. These transactions are debits (subtracts) from your account; depositing money is called a credit.

You can write checks to pay for expenses. The amount of the check is subtracted from your account when the person sent the money deposits the check. A checking/current account is a way to manage cash, have a record of what you have put into the account and what you have spent. It is a way to prove that you have paid someone what you owe and also helps to not carry large amounts of cash on hand which can be risky in some places.

Tell Me More

While a checking/current account is a great way to manage your money, banks often charge a monthly fee for the service. Different banks offer different kinds of accounts. Some require that a certain amount of money be kept in the account. If there is not the required amount, the bank may charge a larger fee.

After opening a checking/current account, you will want to keep a running balance to track the amount you have in your account and review the transactions monthly. This will help you catch any errors that you or the bank has accidently made. Tracking your transactions is also helpful to know what money is coming into and out of your checking account and to budget accordingly. This is done using a bank register.

Your checking/current account should only hold the money that you need for your daily transactions during the month. Some banks may offer checking/current account that pay you interest on the amount of money in your account, but the rates are usually lower than a savings account. If your checks or debit card is stolen, it is important to report it immediately. The bank can stop payments on your account and prevent anyone else from using it.

A Savings account is similar to a checking/current account except that you mainly deposit money to save, and in some cases get paid interest on the amount in the account. You cannot write checks from a savings account. Using both a savings account and a checking/current account is a great way to keep your money organized. Large amounts of money can be stored in savings accounts and used to save up and pay for large purchases. This keeps the money separated from your daily checking/current account spending and makes it easier to track.

How do I set up a checking/current account?

Step 1: Research and visit as many banks as you can. Banks have different features and charge different fees from one another and you want to find the one that works best with your needs with the lowest fee. Ensure the bank has services that match with the needs of your business such as bank-to-bank transfer, exchange facilities, online banking, etc.

Step 2: Decide how much money you want to put into the account for the bills for the month. Keep some cash out of the bank for small purchases, called petty cash. Review monthly expenses on your Income profit and loss statement or what you have spent that month to help decide the minimum amount of money to put into the account to pay for expenses.

Step 3: Visit the bank that is most accessible and has the smallest fee. Complete the application to open the account.

How do checks work?

Step 1: You will receive a book of checks and a check register where you can record all checks used. The checks will have your name, business name, address, and a check number on each.

Step 2: In the register, write down the date and how much money you deposited (put into the account).

Step 3: To write a check, write the date, who the check is going to, the amount of the check in numbers and then in writing and sign your name. You may write the reason for the check on the line above the account number.

Step 4: In the register, write the date, the number of the check, who the check is for, the amount, and what the check is paying for. In the last column, subtract the amount of the check from the balance (what you have in the account). At the end of the month, deduct any fees the bank may have charged.

Step 5: At the end of the month, you will receive a report (bank statement) from the bank telling you how much money you put in (deposits), a list of the checks you wrote, the date the check was cashed, the amount of the money taken from the account, and how much is left in the account (balance.)

Step 6: Compare the balance you have in your register with the bank statement. They should be the same. If they are not, review your addition and subtractions for errors. You may need to contact the bank if your balances do not agree with the bank.

Glossary Terms from this Section

Bank Statement – A monthly bank report showing every deposit, check, and balance of a savings or checking account.

Check – A special paper used to pay for expenses from a bank checking account.

Debit Card – Uses money from a checking account.

Expenses – Money paid out of the business to pay for an item or service.

Income Statement – A financial document showing the difference in revenue (income) and expenses.

Interest – Money paid regularly at a specific rate for the opportunity of borrowing money.

For More Information Related to this Topic See:

- What are Income Statements (Profit and Loss Statements) and how do I use them? *12. Financial Management*
- What are debit cards? *12. Financial Management*
- Why don't I have enough cash in the bank? My budget said I should be making money. *10. Budgeting*

Additional Tools Available

Bank Register

16.
What are loans and interest and how do I manage them?

The Basics

A loan is money borrowed from an individual or bank that is expected to be paid back over a certain timeframe with added interest. Interest is money paid regularly at a specific rate for the opportunity of borrowing money. The terms of a loan are agreed to by each party in the transaction before any money changes hands. Loans can be received from both formal financial organizations and from informal sources, such as your family, friends, fellow businesses, suppliers, partners, and key buyers. If you receive a loan from a family member or a friend, they may not charge you interest, however, if you receive a loan from a bank or other organization, expect that you will be charged interest.

Loans can be used as a great way to gain access to cash quickly and pay it back later. The loan can be used to purchase equipment or other needs, expand your business, or make an investment you normally would not be able to afford without saving a lot of cash first.

Tell Me More

While loans are very useful, it's important to note that every loan must be paid back with added interest. Depending on who loans the money to you, the interest rate percentage can be high and must be taken into account when considering whether or not to take a loan.

Loans can come from friends or family, but most loans are given by banks, governments or micro-finance groups. Here are some steps to consider when thinking about and applying for loans.

Step 1: When taking a loan, you must find out certain facts:

- What will the term of the loan be? (The term is how long you are allowed until it is paid back.)
- What is the interest rate percentage?
- What asset do you have as collateral (something of value you own that will be taken if the loan is not paid back) to get the loan?
- What are the penalties if you cannot pay back the money?
- Will you need to have someone co-sign/guarantee (someone who will be responsible to pay back the loan if you cannot) with you to guarantee repayment?
- How much do you expect to be able to pay back each month for the loan?
- Can you pay the loan back sooner to save interest costs?
- Is the loan conventional or Islamic? (If this feature is important to you)

Step 2: What are the differences among lenders?

- Banks will usually require the most information and may require collateral. There may also be fees for setting up the loan.
- There are many micro-finance entities, funded by other governments, which provide loans. These are usually large companies serving several countries and have many employees. Micro-lending cooperatives offer loans with fewer requirements, but the borrower is usually part of the group and the group takes responsibility for the repayment.
- Friends and family may be easier to get a loan from but the amount of money usually available to borrow is lower. They may or may not ask you to pay a small fee or interest for the loan. But be aware - there may be damage to the relationship if you fail to repay the loan.

Step 3: Interest Rates
Interest rates and terms will vary depending upon who is lending the money and your credit history. If you have not borrowed before or if you have been late in repaying other loans, you will probably be charged a higher interest rate. Some lenders will give lower rates to people who have better loan history or have been good customers for them in the past. Each bank or lender will have different ways of deciding.

Step 4: How will you manage the loan?
First, be sure you will have enough cash flow to be able to pay back the loan payments each month. If you are using the money to buy supplies for the future, be sure you will be selling enough of your product to earn the revenue needed to pay back the loan.

Be sure the interest rate is reasonable for you. Different lenders may have different rates and you should try to find the lowest interest rate possible.

Read the lending agreement in details so you are aware of its terms and conditions before signing.
Pay back the loan as agreed upon in the loan terms. Being late to pay or not paying at all will cost you a lot in penalties.

In your Income Statement (P&L) and Balance Sheet, include the interest rate amount of the money borrowed. (interest rate multiplied by the money owed)

Glossary Terms from this Section

Balance Sheet – A financial document that shows how much you have in your business and how much you owe at a given time.

Credit – A contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some date in the future, generally with interest.

Income Statement – A financial document showing the difference in revenue (income) and expenses.

Lender – A person or organization who offers others an amount of money to use for a fee.

For More Information Related to this Topic See:

- What are Income Statements (Profit and Loss Statements) and how do I use them? *12. Financial Management*
- What is a cash flow statement? *12. Financial Management*
- What are liabilities? *12. Financial Management*
- What are fixed and variable costs? *12. Financial Management*
- How do I estimate what things will cost in the future? *10. Budgeting*

17.
How can I manage my costs and expenses?

The Basics

Managing your expenses to help increase your profit is important for the success of your business. Review your income and expenses to determine if you are losing money, breaking even or just barely making a profit. If you are losing money, you probably need to reduce your costs to balance out those losses. Examine each expense, no matter how small, and determine which you can do without.

Each week or at least monthly you should examine both your expenses and revenue using reports such as your Income Statement (P&L), Budget, Cash Flow Statement and Balance Sheet. Then make any adjustments as needed, especially when you notice that you are spending more than your budget allows. Areas important to your business›s income, like expenses related to production or marketing, should be some of the last items to cut.

There are many tools to use such as your Income Statement (P&L), Budget, Cash Flow Statement and Balance Sheet. These reports come from your bookkeeping so it is very important to be accurate and stay on time with this information.

Tell Me More

When reviewing your expenses using your Income Statement (P&L), Budget, Cash Flow Statement and Balance Sheet, consider the following areas to cut expenses.

Rent:
One fixed cost is your building or office space rent. As you look at the space you have, how you use it and, where it is, consider the possibility of sharing space and rent with another person or business? Would another business help bring in more customers? Would it be competition? Is there rental space available elsewhere that would cost less? Can you operate out of a local co-working space? You may also consider renegotiating your rental terms.

Hours:
Keep track of when your customers come in. Are there hours or days when no one or very few people come to your business? Are there hours when many people tend to come to your business? You can adjust your open business hours away from slow times and toward more busy times. This can help save expenses like payroll and electricity. Be sure you put up signs outside so that people know when you are open.

Payroll:
Use staff only when needed such as during very busy business hours, seasons that require more labor, and consider splitting up duties among other staff to keep a lower number of employees.

Inventory:
Look at the prices you pay for your inventory or supplies. Would it cost less if you buy larger amounts? Are there times of the year when supplies would cost less?

Look at the cost of storing your inventory. Are you spending too much on storing extra inventory you don’t use or won’t use for a long time? Consider buying inventory or supplies as you need them instead of spending money to store it. Consider discounting items that don’t sell as well or you have a lot in inventory, to clear out needed room. Paying less to buy supplies and inventory or the space to hold it helps lower expenses.

Loans:
Loans have interest payments that must be paid back regularly in addition to the original loan amount. Some lenders will allow you to pay back the loan sooner. This helps you save money on paying interest expenses. Fees can be an unneeded expense. Be sure to make payments for loans and credit on time to avoid paying fees.

Some financial institutions provide Sharia-compliant lending. Ensure you learn everything about the type of Sharia-compliant loan that suits the needs of your business the most. For example, a Murabaha product is most suitable for a trade business. Musharakah or Mudarabah are more suitable to investments that take very long to have a return. The cost of borrowing is usually comparable to an interest-based loan, but the structure, payment schedule, and other characteristics of a Sharia-compliant loan can be different. You can learn more about Sharia-compliant lending by visiting a local financial institution and asking for more information. Feel free to ask for details, get copies of their brochures, and receive an application to review. Another way is to ask a familiar colleague, family, or friend to help find more information on the Internet. Be cautious not to trust just any website. Look for sources of information and credibility of the organization that publishes it.

Glossary Terms from this Section

Balance Sheet – A financial document that shows how much you have in your business and how much you owe at a given time.

Bookkeeping - Keeping track of financial activities in a business.

Cash Flow Statement – A financial document showing the money that is flowing into your business and the money flowing out of your business.

Expenses – Money paid out of the business to pay for an item or service.

Fixed Costs – Money spent that does not change depending on the number of products you sell.

Income – All the money that comes into your business from sales, service or loans.

Income Statement – A financial document showing the difference in revenue (income) and expenses.

Profit – Any positive amount of money left over after subtracting expenses from revenue (income).

Revenue – Money coming into the business usually from sales of goods or services.

For More Information Related to this Topic See:

- What are Income Statements (Profit and Loss Statements) and how do I use them? *12. Financial Management*
- What is a cash flow statement? *12. Financial Management*
- What are liabilities? *12. Financial Management*
- What are fixed and variable costs? *12. Financial Management*
- How do I estimate what things will cost in the future? *10. Budgeting*

18.
How do I plan for spending money for my business?

The Basics

There are many factors that make a business successful. A successful business owner will weigh these factors and decide what to invest in so that her business can grow. They may not be able to invest in everything at once, but she can plan what things to do now and what to do in the future. Planning for spending money in your business (investment) requires knowing how it will affect your business and how it will be paid for. Some of the factors that can impact a business are:

Location: Can your business be easily found? Is it a safe area? To have a good location, you may need to pay a higher rent.

Purpose: What does your business do? Does it provide a product or service that people want or need?

Price: Are your prices affordable or luxurious? To help keep prices low, you need to buy your materials and supplies at a low cost. If your prices are high, does the quality of your product or service justify the higher price? Quality and Reliability: Is the quality of your product or service consistent and match what the customer expects? Or does the quality of your products or services vary? To ensure a high quality product or service, you need to have the right (or best) equipment.

Customer Service: How do you treat your customer? Do you provide a positive customer experience that leaves them wanting to come back and purchase from you again? To ensure good customer service, be sure to have the right people with the right skills or provide effective training in positive customer service.

Appearance: Is the look and feel of your business inviting to customers where they find it a comfortable place to buy?

While some things a business owner may spend money on are optional, some expenses are not. For example, taxes are an expense that must be paid. Managing your cash flow can help ensure that the money will be available when it comes time to pay those expenses.

Tell Me More

Here is an example of how one business owner approached how she considered making investments in her business. Fatima runs a beauty parlor. She knows that her prices, the quality and reliability of her services, the appearance of her shop, and her customer service will all impact how many sales she can make. Here is how she considered each factor.

Prices

Fatima wants to be sure her prices are the best they can be. Her prices are about the same as other beauty salons but she wants hers to be better for her customers.

Step 1: She looks over her invoices to see what she has been paying and where she has been buying her supplies and products. She looks for other places that may sell what she needs using the internet or she calls other suppliers.

Step 2: When she finds other suppliers, she asks if they lower their prices when they have too many products and if prices will be lower if she buys larger orders. She also asks how high are the shipping costs?

Step 3: If they have lower prices when she buys larger orders, she has to be sure she has a safe place to store the items. She also has to see if she has enough cash at the time to pay for the orders. If she does not have the cash available, another option would be to buy the orders with credit.

Quality and Reliability
Fatima wants to be sure her customers will be happy with the quality of her services.

Step 1: She looks at her hairdryers. Are the dryers doing a good job? Are they too noisy? Do they go off when they should be on? Do they use more electricity because they are too slow or old?

Step2: Fatima decides she needs new dryers. She will look for companies that sell the dryers to check the prices and their level of quality. She decides when to have them installed, how long it will take to install them, and what are the costs of delivery and installation.

Step 3: Fatima looks at her financial statements to see if she has cash available. If not, can she buy them with credit? If not, will she take a loan from a a family member or a micro-lending lending organization? How long will she have to pay and what will the interest rates be?

Appearance
Fatima's business is growing and many people come and go. The salon needs new flooring and painting.

Step 1: Fatima looks for new flooring that will make the salon look newer and attractive. She will find the best product and the best price.

Step 2: Fatima looks at her income statements and appointment books to see when business is slower so that she can have the floors installed and the painting done so it interferes with the fewest number of customers and her business. Or she may have to close the salon while they are being installed.

Step 3: Fatima looks at her financial statements to see if she has cash available. If not, can she buy paint and pay the painters with credit or take a loan from a family member or a micro-lending organization? How long will she have to pay and what are the interest rates?

Customer Service
Fatima wants to be sure her customers are happy with her service.

Step 1: Fatima asks her customers to tell her what they think of her service and asks them for suggestions. She visits other salons to see if there are improvements she can make to her services. She watches her employees to see how they treat and talk with customers.

Step 2: Fatima tells her employees that she wants to set aside some time to train them on best practices on effective customer service. She knows that customer service is very important for the success of her business.

Each decision you make will have an impact on your expenses and profit. When you plan to improve your business, make sure you know how it helps your business grow or sell more. You can also stage your investments and see how each step brings you more revenue before you invest more. Make investment when you know it helps your business.

Glossary Terms from this Section

Invoices - A list of thing or services provided and the amount of money to be paid.

Credit - The trust and opportunity to pay for things you purchase at a later date.

Interest - Money paid regularly at a specific rate for the opportunity of borrowing money.

Revenue - Money coming into the business usually from the sale of goods or services.

Customer Service - All the activities carried out to satisfy customer's expectations before, during and after a purchase.

For More Information Related to this Topic See:

- Can you explain what is 'supply and demand' and why do I need to understand it? *9. Pricing*
- How can I find out what my customers are willing to pay? *9. Pricing*
- How do I set pricing based on value? *9. Pricing*

19.
What does seasonal mean for income and expenses in my business?

The Basics

Most organizations experience some changes in business caused by weather changes in seasons, cultural seasons like holidays, or events such as children returning to school. These changes in seasons can have a small or large amount of impact depending on the type of business you have.

Seasonal weather businesses may have very low demand or low output during a particular season or may even shut down completely for a time. For example, farming can be very busy much of the year but slow down or even stop during winter. An Ice-cream business, such as Iceland in Kabul, may see fewer customers when the weather is too cold. During seasonal events such as Eid holidays or the beginning of a new school year, a surge in business may be likely and can be taken advantage of for increased sales.

These seasonal changes can influence your sales throughout the year. Proper planning is crucial to balance out the months of high income and the months of low income. By recognizing the seasonal changes you can plan to save or invest when business is good and limit or eliminate expenses (money paid from the business) when business is poor. Think of the various seasons that may affect you and how you might prepare for, and take advantage of, the changes.

Tell Me More

It is important to recognize, be prepared for, and take advantage of seasonal changes. Follow Amina's example as she identifies and utilizes the changing seasons and what that means for her business income and expenses.

Amina buys fruits and vegetables from farmers and employs people to transport, clean and package them to sell to markets and restaurants.

Step 1: Amina looks at her Income Statement (P&L) and Cash Flow Statement and sees that she has a lot more income and expenses during and after the summer months but few sales in the winter months. Knowing seasons can affect her business, she looks closer to see how she can best manage flow of the seasons.

Step 2: Amina examines her fixed costs and variable costs. She will have to pay the fixed costs of rent and loan payments (taken when she started her business) no matter what season it is. Her variable costs such as payroll (salaries to employees), transportation, and marketing will fluctuate depending on the busy season and how much she sells.

Step 3: Because there are fixed costs Amina has to pay regardless of her sales, she must find a way to cover these costs. Amina decides that she needs to save the profits from the spring and summer months in order to cover her fixed costs during the winter. Amina can also raise the price of her products to increase the profit she receives during the good months. She will need to do market research to see if, and at what higher price, people will pay.

Amina can cut any unnecessary costs during the winter months where there are little sales. With fewer products to sell, she doesn't need to pay for employee labor or transportation. She can also reduce her business hours, turn off electricity, or reduce the area used to store her inventory.

Step 4: Amina looks for possible byproducts (something produced in the process of making something else) to add to her business. Amina comes up with the idea to use the food waste she has from preparing her products and sells it to another business to be turned into food for livestock during the winter. She also has the idea to rent out her vacant trucks to another business to transport equipment and supplies to retail stores in different parts of the city.

Glossary Terms from this Section

Cash Flow Statement – A financial document showing the money that is flowing into your business and the money flowing out of your business.

Fixed Costs – Money spent that does not change depending on the number of products you sell.

Income – All the money that comes into your business from sales, service or loans.

Income Statement – A financial document showing the difference in revenue (income) and expenses.

Market Research – The activity of gathering information about consumers' needs and wants.

Marketing – The process of reaching your customers and showing them why they should buy your product or service.

Profit – Any positive amount of money left over after subtracting expenses from revenue (income).

Variable Costs – Money spent to make and sell your products and goes up together with each product sold.

For More Information Related to this Topic See:

- What are Income Statements (Profit and Loss Statements) and how do I use them? *12. Financial Management*
- What is a cash flow statement? 12. *Financial Management*
- What are fixed and variable costs? *12. Financial Management*
- What is profit, how do I determine mine, and what is my goal? *12. Financial Management*
- What is marketing? *6. Marketing*
- What is market research and how do I do it? *6. Marketing*

20.
Are there any byproducts of my business that can produce revenue?

The Basics

Byproducts are the items or results produced in the process of making something else. They are what is left over after a producing a product or from an activity. Byproducts tend to have a lower value compared to the primary product produced and is often discarded as waste. Sometimes these byproducts can be sold as they are, or after further processing, to earn more revenue which can add to the profits of a business.

For example, dairy farmers use cows to produce milk to sell. A byproduct of cattle is manure. The farmers primary product is milk but also has left over manure which has a lower value. To earn additional revenue, the farmer can sell the manure to other farmers or to landscapers as fertilizer.

Tell Me More

Take these two examples of how Amina and Fahima benefited from byproducts:

Amina buys fruits and vegetables from the farmers in the region. She cleans them and packages them to sell to restaurants and shops. The branches leaves, husks, peels are "left over" byproducts. These would make good compost fertilizer.

Fahima makes wooden decorative items. She buys large and small blocks or planks of wood to make different sizes of bowls. She then cuts, scrapes and polishes the wood to make the bowls. There are small and larger pieces of wood "left over". These could be used for firewood.

Amina and Fahima need to know who would want the left overs and what they would pay for them. The money they receive for the leftovers would be revenue.

Step 1: Amina and Fahima go to the market and see what fertilizer and firewood are available and what are the prices being asked. They also look at the size of the packages that are selling the most. This activity is part of market research, the gathering of information about consumers' needs and wants.

Step 2: Amina and Fahima then talk with friends, family and people at the market to ask what they need or what kind of product they might like. They also decide to talk with members of a farmers cooperative group.

Step 3: After reviewing all of the information they had gathered, Amina and Fahima decide to package their fertilizer and wood (by-products) in the sizes that seemed to sell the best and set a price based on what they learned at the market which includes their time and the costs of the packaging (labor and materials).

Step 4: They decide to sell the by-product packages both at their own shops and sell them to the merchants to sell in the market. By including the byproduct fertilizer and wood alongside their normal products, they add to their income and also save time or expense of disposing of the waste.

On Amina's Profit and Loss Statement, she will not only list the income that she receives from selling fruit, but she also will record the income she receives from selling the fertilizer that she makes from the peels and husks. It isn't as much as she earns from her fruit sales, but the extra income comes from something that she might have just thrown away.

INCOME	Sawr (AFN)	YTD (AFN)
Pomegranates	35,000	60,000
Apples	25,000	40,000
Apricots	15,000	35,000
Figs	10,000	18,000
Sales of Fertilizer	3,000	7,000
TOTAL Income		

Using imagination and market research to look for ways to create new business from byproducts can be very productive. The byproducts can also be important in receiving revenue during times when the main part of the business may not be busy.

Glossary Terms from this Section

Expenses – Money paid out of the business to pay for an item or service.

Income – All the money that comes into your business from sales, service or loans.

Market Research – The activity of gathering information about consumers' needs and wants.

Profit – Any positive amount of money left over after subtracting expenses from revenue (income).

Revenue – Money coming into the business usually from sales of goods or services.

For More Information Related to this Topic See:

- What is revenue and how do I know mine? *12. Financial Management*
- What is profit, how do I determine mine, and what is my goal? *12. Financial Management*
- How can I manage my costs and expenses? *12. Financial Management*
- What is market research and how do I do it? *6. Marketing*

21.
Can I manage the amount of taxes I need to pay and plan for my tax expenses?

The Basics

Every business must pay taxes. Taxes are used by the governments of the town, city or country to pay for the services all people need. These may be roads, hospitals, police, street lights, water, schools, garbage removal or other services that make our lives safer and better. Taxes are usually based on the value or income of the business or the value of the property.

Be sure to understand the interpretation of Income Tax Laws of Afghanistan as it applies to your business. You can keep your business license valid for as long as you pay your tax obligations to the government. Many businesses with a vision to grow purposely plan for the taxes they expect to pay with as much accuracy as possible. You can easily plan for and manage your tax obligations if you are aware of the different taxes your business must withhold and pay to the government.

Tell Me More

Businesses in Afghanistan are subject to Income Tax law and the government of Afghanistan updates the laws from time to time. Keep yourself updated with any new developments of the laws set by the government. The best way is to stay in touch with the Small Taxpayers Office, Medium Taxpayers Office, or Large Taxpayers Office who work under the umbrella of the Ministry of Finance that administers the overall revenues of the government.

Reporting your revenue and expenses to the government is required by the Income Tax Law. At the end of each month, each quarter, and each year you have to disclose your revenue and expenses to the government and pay the required taxes. The government of Afghanistan has set penalties and fines on businesses that do not report and pay taxes on time. When you are diligent about and aware of the taxation requirements, you can easily remain compliance and keep your business running. Study the Taxation Guideline tool to learn detailed information about the different taxation requirements.

There are five types of taxes that you need to be aware of and pay close attention to:

Employee Tax Withholding
When you pay salaries to your staff, you are required to withhold part of your staff's salary and pay to the government. There are different tax brackets and your staff may fall into one or more of these categories. Refer to the Tax Guideline tool for reference to the different brackets and to the Tax Calculation Sheet to find the amount of tax you need to pay for each level of salary.

Rental Tax Withholding
Rental tax is paid to the government based on a certain percentage of the monthly rent to the building you use for your business.

You may be able to negotiate with the landlord of your building at the contracting stage for you to withhold the require tax amounts from the rental payments. Businesses that do not withhold and pay the rental tax to the government still have to pay such taxes even when they have not withheld anything from the rental payments to the landlord.

Contractor Tax Withholding
Contractor tax is paid to the government, based on a percentage of a payment to a subcontractor.
If the value of the contract per year is less than 500,0000 AFN, you do not need to withhold any amount but

must report the payment to government within 10 days after the end of the month in which the payment was made. For subcontractors with a valid business license, you are required to withhold 2% and for those without a valid business license, you are required to withhold 7% of the payment and pay to the government.

Business Receipts Tax Return
The revenue that you receive from different business customers is subject to government taxation. For example, when you receive a payment from a business customer into your bank account, you will be required by the government to pay 4% of that to the government. Some business customers withhold 2% from your payment and pay it to the government on your behalf. The remaining 2%, you will need to pay directly to the government yourself. Be sure to obtain a copy of the tax receipt for your records.

Annual Income Tax Return
At the end of the year, businesses are required to submit a detailed report to the government on your revenues and expenses. The tax offices of the government provide the formats and templates for these reports for free. These forms are basically a Balance Sheet, an Income Statement, tables, and schedules with a few minor differences. Having your financial statements ready will help fill out these forms easily and submit them to the government. In general, the government requires businesses to pay 20% of their net profit after deducting expenses from their taxable revenue.

Dealing with taxation can be difficult and intimidating, but with the right steps you can easily pay your taxes and keep your business running. Consider the following steps:

Step 1: Have a proper bookkeeping system to help you generate financial statements, and also help you in paying your taxes. When you have good records, you can more easily pay your taxes in time.

Step 2: Identify the different types of taxes you are required to pay. Fill out the necessary forms from the government at the end of each month, quarter, and year based on your financial statements. Make sure you understand the forms well. You can ask your accountant or an external taxation service provider for assistance. Service providers charge a small fee and get your taxation work done for you.

Step 3: Based on the taxation forms, you will need to pay the calculated tax amounts directly to the government's accounts. The tax bill should be included in your accounts payable report so you will remember to pay it. Make the payments and ensure to keep your receipts. Also, keep your taxation forms and documentation properly filed for future reference.

Step 4: Keep documentation complete and handy after you meet your tax obligations. The government often has assessors, people who know what the taxes should be, and who look into your business or property to verify proper taxes are being paid. They may visit in person or ask you to provide documentation for your revenue and expenses. For the income of your business, they will ask for a report of your revenue each year or every three months. For expenses of your business, they will ask for proper evidence that show the expenses were made. Keep your records for at least five years. Based on Afghanistan Income Tax Law, the Ministry of Finance has the right to ask for documents within five years.

Step 5: Get a clearance letter from the government's tax department. You will receive a letter at the end of the financial year once you meet your tax obligations. The government may not audit your business immediately after each year, but may choose to do so eventually. Keep your documentation organized and handy.

The different government offices have working relationships and legal obligations to ensure businesses pay their taxes. Business licensing offices and tax offices are well connected. You can keep your business license valid when you meet your tax obligations. The best way to manage taxes is to be aware of it and pay the taxes to the government as soon as they are due to avoid penalties.

Glossary Terms from this Section

Accounts Payable - Money owed by a company to its creditors.

Balance Sheet - A financial document that shows how much you have in your business and how much you owe at a given time.

Expenses - Money paid out of the business to pay for an item or service.

Financial Statements - Formal records of the financial activities of a business that includes a balance sheet, income statement, and cash flow statement.

Income Statement - A financial document showing the difference in revenue (income) and expenses.

Revenue - Money coming into the business usually from the sale of goods or services.

For More Information Related to this Topic See:

- What is revenue and how do I know mine? *12. Financial Management*
- What is a cash flow statement? *12. Financial Management*
- What are financial statements and why do I need to use them? *12. Financial Management*
- What are Income Statements (Profit and Loss Statements) and how do I use them? *12. Financial Management*
- Why do I need a balance sheet and how do I create one? *12. Financial Management*

Additional Tools Available

Taxation Guideline

Tax Calculation Sheet

22.
What are the best ways to handle transactions including cash payments?

The Basics

Business transactions are the interactions between businesses and their customers, vendors and others they may do business with. Transactions can be very simple (like buying a newspaper) or be very complex (like buying an office building) which take a long time and involve many other businesses. Typically, some bookkeeping is required to record what happened. This can be done by hand or using a computer especially if there are many transactions being done.

Cash is easily used for buying and selling goods and services. It is most widely accepted everywhere and used for both personal and business transactions. The drawback to cash is that it is easily lost or stolen. For a business, theft and not easily being able to know how much cash is coming in or out can be a big problem. Using checks or credit cards are more secure but may require more processing, the purchase of additional equipment (credit card processing machine), and electronic tracking. The most important element is that the owner must be able to account for all transactions including cash.

Electronic payments are becoming more commonplace throughout the world including Afghanistan. The most common form of electronic payments are using mobile phones. As a business owner, you want to keep pace with new technologies and ensure that you are providing all possible payment options to your customers. These new technologies can make transactions more simple, easy, and safe. Offering electronic payments can be an advantages you have over your competition who may still be only accept cash payments.

Tell Me More

Ensure payment.
It is very important to keep track of when a payment has been received both so that you know if a customer has already paid, or still needs to pay for a product or service. It is also important so that you can go back later and track who made the purchase, when it was made, for what product or service, and for how much. Being able to go back and track the transactions can help you know what products or services are selling most, the price you charged, what type of customer bought the product, and be able to account for how much money has been received or paid out.

For example, Fatima runs a small restaurant offering authentic food in a very busy part of town. Many customers come in during lunch where it can get very crowded. Two customers have walked out of the restaurant but Fatima does not know whether they have paid or not.

Fatima can give a paper receipt as each customer pays for food. She can then verify with the customer that she has paid by looking at the receipt. The receipt will have a copy and will tell the date, what the cash paid for, the amount and will have the name of the person collecting the cash. One copy goes to the customer and one copy Fatima will keep. The receipt will be used to record revenue (money coming into the business) on the cash ledger for bookkeeping or in a bank register. At the end of the day, Fatima will compare the total on the receipts with the cash in the drawer to be sure it is all there.

Avoid carrying cash.
As cash can be easily lost or stolen, it is best to avoid carrying large amounts of cash around. For example, Fatima goes to the wholesale market to buy supplies for her shop. She selects several products and they require a large payment. Fatima is concerned about carrying that much cash but she needs to pay for the supplies. Fatima has deposited cash into her checking or current account. Instead of using cash, she writes the dealer a check from her business checking or current account. She will record the check in the check register and will

have a record of the payment. At the end of the month, the bank will send her a monthly statement showing that the money was paid to the dealer.

Delayed Payment
Fatima is buying new chairs for her restaurant. They will be delivered in three weeks. Fatima does not want to use her money at this time because she has other bills to pay and is expecting to have more money in the two weeks. Her solution is that since she and her business are trusted, she has arranged to use credit to purchase the chairs. The shop owner has agreed to let her purchase the chairs but not pay until the chairs are delivered. Fatima has to be sure she can pay at the time the chairs are delivered or she may have to pay high fees and lose her credit (trust) with the shop owner.

Glossary Terms from this Section

Bookkeeping - Keeping track of financial activities in a business.

Check - A special paper used to pay for expenses from a bank checking account.

Check Register - A list of check, debit and credit transactions for a checking account.

Checking account - An agreement with a bank that allows money to be put into the account and the writing of checks to pay for expenses.

Ledger - A ledger is a complete record of financial transactions over the life of a company.

Vendors - A person or organization who offers a product or service for sale.

For More Information Related to this Topic See:

- What is revenue and how do I know mine? *12. Financial Management*
- What is a checking or current account and how do I use it? *12. Financial Management*
- What is bookkeeping? *11. Bookkeeping*
- What is a ledger? *11. Bookkeeping*
- How do I manage cash? *11. Bookkeeping*

Additional Tools Available

Bank Register

Tools