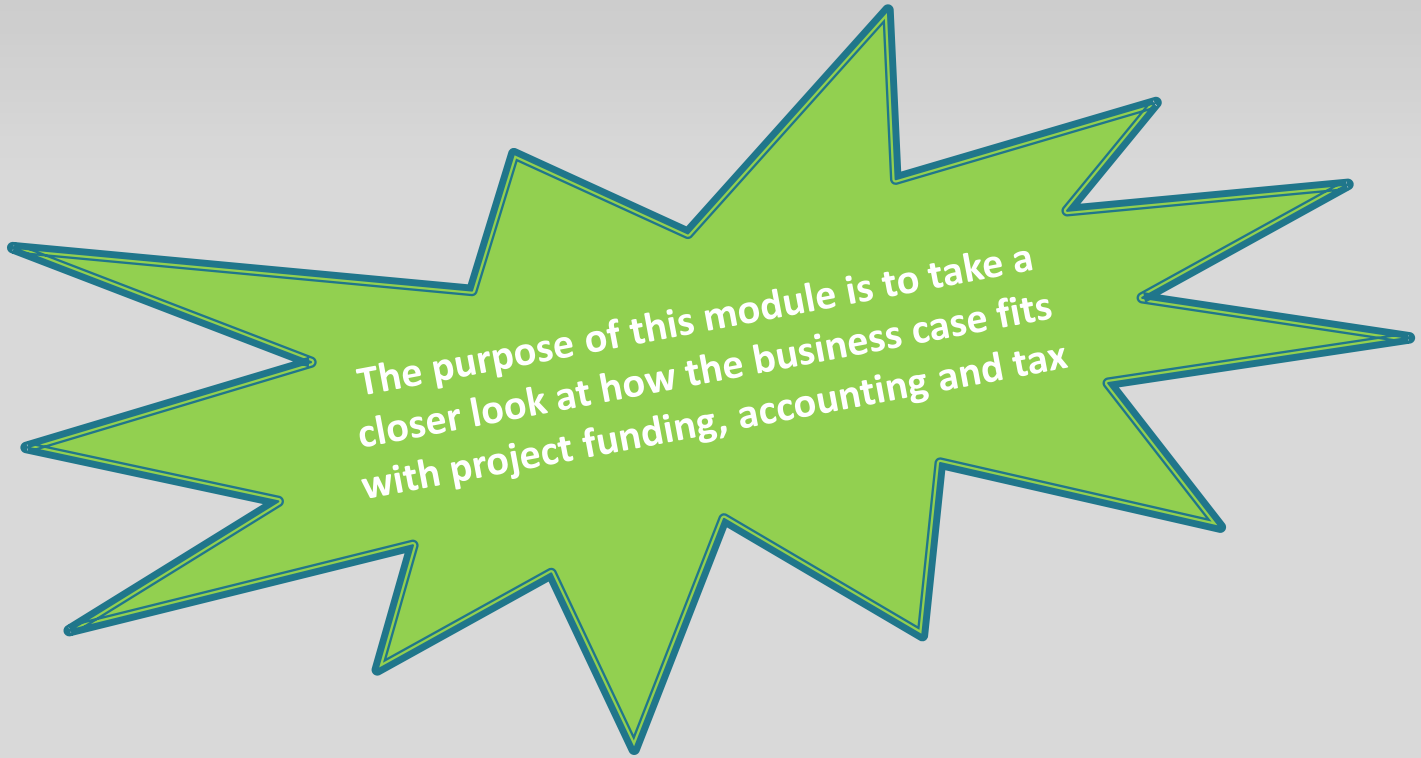
Teach yourself how to build a Business Case for a Social Enterprise or Community Project

1d A closer look at the business case, accounting, funding and tax



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Disclaimer: It may contain errors so always check your own work and have it audited by a competent person

During the project's life, there will be four key activities dealing with money.

- **Each is essential:** one is not more important than the other
- **Each has a different purpose** but they all use much the same data in different ways
- **Different skills and different people are required**

1. ople decide to try to make a good idea work for a community.
2. **nent:** They work together to decide what is required, how it will be the likely outcomes, what it will cost.
   t may use cept', 'pre-feasibility '& 'final feasibility'
3. **pprova** unit ut it into action.
4. money
5. establish the project an ration
6. ple may run, expand and diversify ma a local organisation once it is established
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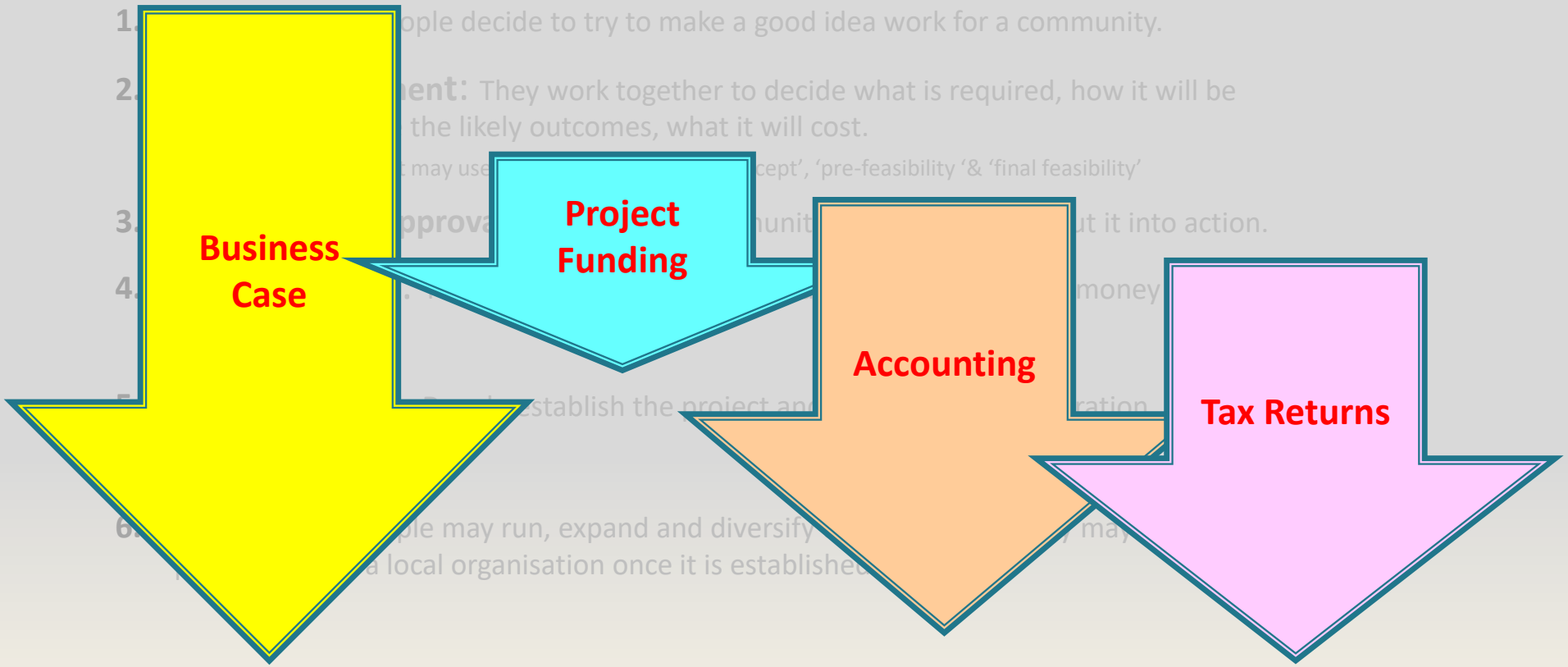

They are done by different experts for different purposes: -

The **business case** is hands-on for the project leaders and team.

It is done by a practical generalist working mostly within or alongside the project team and interacting frequently with the leaders and the team.

(later it can be given to potential donors, investors and lenders)

Project Funding is for the investors, donors and lenders.
It will be done by professionals mainly interacting with outside investors and lenders

Accounting is for project managers, investors, lenders, community, government

It will be performed by professional accountants, mostly on their own, working through records and interacting occasionally with the project leaders and team

Tax Returns are for the government
They too will be performed by professionals/ accountants, mostly on their own, working through records and interacting occasionally with the project leaders and team

The first three will be reporting outside the project and will be following mostly strict, internationally set procedures, whereas the **business case specialist will be reporting inside the project by voluntarily adopting world-wide practices to fit the project.**

1. Business Case

1. **Project Idea:** People decide to try to make a good idea work for a community.
2. **Project** work together to decide what is required, how it will be done, wh tcomes, what it will cost.
   1. A r tages of study: 'concept', 'pre-feasibility '& 'final feasibility'
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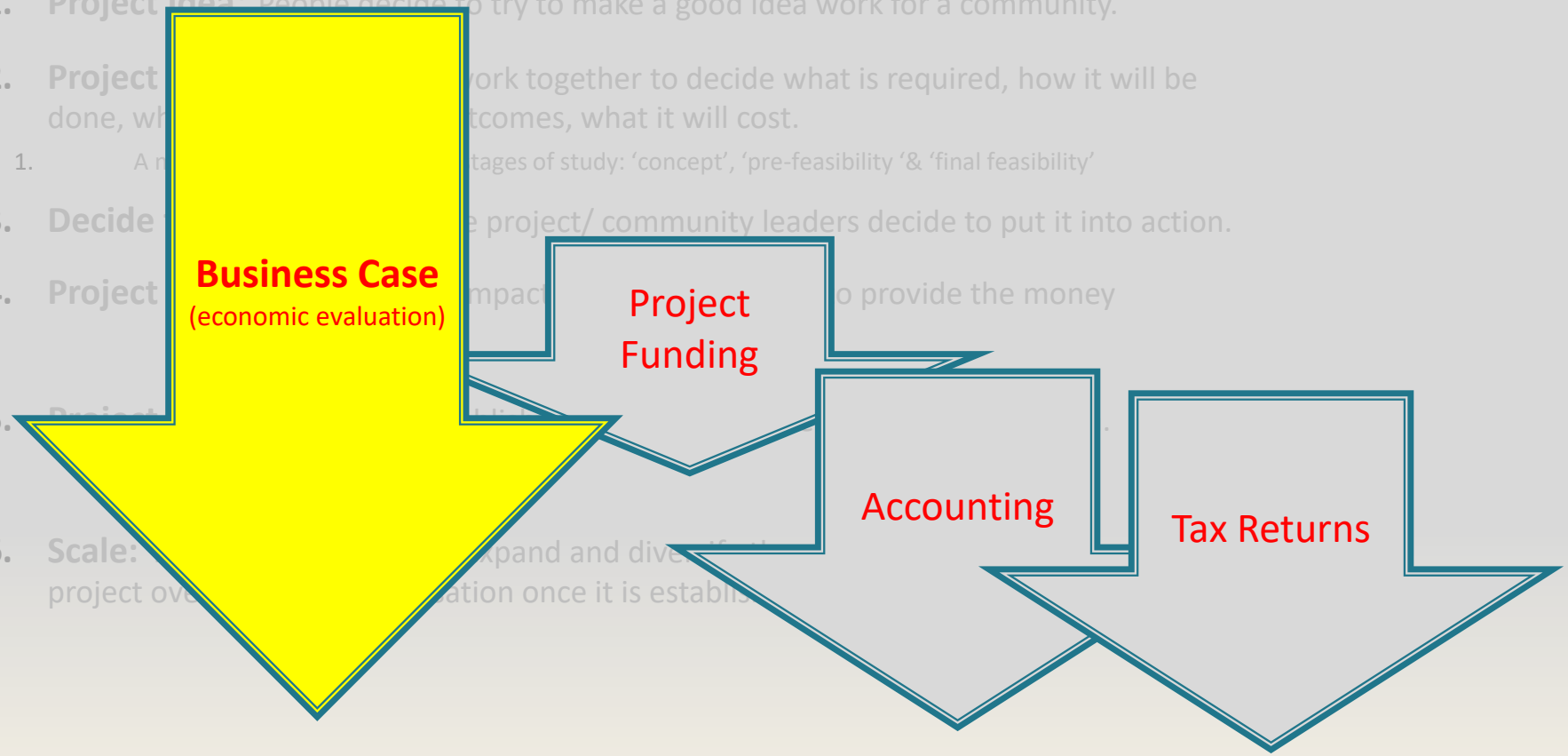

The business case is a three step process ...

1. Create the business model in Excel
2. Use the business model to properly understand the project
3. Use the findings to help make both small and big decisions on the future of the project

This process evolves over the life of the project.

At each major stage, the business model will be updated and the evaluation revised.

The business case is not completed because it is some sort of mandatory management procedure, but because it is an easy-to-use ‘steering wheel’ for the social enterprise.

The business case is very different to accounting …

1. It is a forward view of the project from today (or from this year) until it achieves definite viability or until closure.
   Unlike accounting which usually assesses the project over the last month or last year or forecasts for the next month or next year in a 'budget'

2. In a business case, any cash spent in the past is not included but treated as a 'sunk' cost
   Unlike accounting which brings in some of the money spent in the past

3. It usually is worked in 'real terms' (excluding inflation) which means everyone can immediately follow the trends in real price and real cost over the years.
   Unlike accounting that works in nominal terms or dollars of the day

4. It recognises money only when it is spent as cash and received as cash
   Unlike accounting that uses the 'official' sales where the cash may be received at another time.
   Unlike accounting, that meticulously matches past, present and future expenses against the official sales/output in that period ("accrual" method).
   Unlike accounting that can re-introduce a portion of past capital expenditure

5. The business case can approximate and round-off calculations where they have near zero impact on the outcomes and hence have zero impact on decision-making.
   Unlike accounting which must be detailed, elaborate and precise in all details.

If you want to quickly read about NPV, IRR, Payback ...

Some projects will benefit from the evaluation model calculating a few business concepts: -

- "**NPV"** – Net Present Value is how much the future returns from the project are valued at today. In theory, the social enterprise should be willing to take either this cash or the project today. A project with low returns may have a negative NPV, which means that it would not earn enough to properly repay the lenders and investors over its life. (The maths of NPV are reasonably simple)

- **"IRR"** – Internal Rate of Return is the return generating power of the project. If the lenders and investors need a 7% return to make them satisfied, then a project with 12% IRR is healthy whilst a 3% IRR is not.

- **"Payback**" – Payback is simply the number of years the project needs to operate to payback the cash invested up-front by the sponsors, donors, lenders and investors. A three year payback might be good whereas a ten year payback might make investors worry.

Accounting: *These three metrics can be derived by accountants from the accounting statements, but their workings will be convoluted, use accounting concepts and may be very difficult for non-accountants to follow.*

The business case is the easiest of the four to use because: -

1. Everything is exactly how things happen in real life.

2. There are no accounting concepts that seem abstract or puzzling to non-accountants.

3. Its main working tool is an business model in Excel
   which is transparent and easy-to-follow
   with a clear layout and rigorous workings

A true test of a good business model is that people should be able to receive a copy without accompanying explanations and immediately follow the workings from beginning to end. They should be able to readily assess the character and health of the project

2. Project Funding

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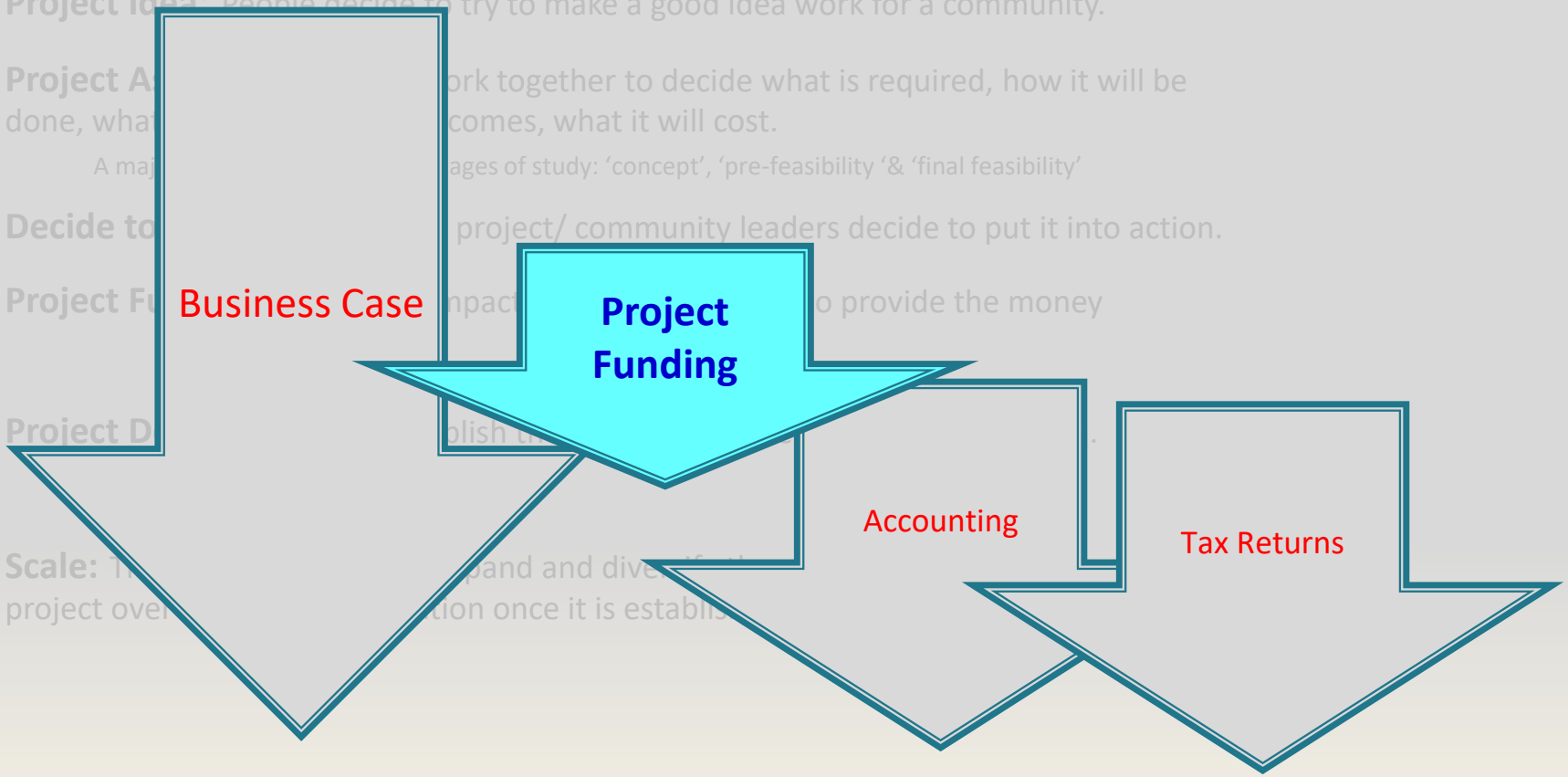

Project Funding ...

Project Funding is all about securing the cash from donors, investors and lenders to establish the project.

Whilst the project is being studied for its economic viability and to select the best design, the social enterprise is likely to be educating potential donors, investors and lenders about the project.

When it is time to ask these groups for solid commitments, they should be primed-up and ready to look deeply at the project and decide.

Key to their commitments will be believing that the social enterprise deserves support …

A proven, powerful tool to help get funding, is a business model that demonstrates to these donors, investors and lenders that the project is viable.

- They can see for themselves that the project will 'stand on its own two feet'.
- It will be able to repay lenders and give investors the returns they seek.

Potential donors, investors and lenders may want to take a copy of the business model and add their own project funding sheets.

- They will investigate the project's ability to repay any lenders and investors under different operating conditions.
- They will especially assess the safety margins if it happens to perform poorly.

The **business case** first assesses the project before project funding.

- Initially it will not consider where external cash comes from to establish the project and where any surplus cash goes when the project starts generating excess cash.
- At first it assesses at the project's economics regardless of ownership, sponsors and investors.
- It looks at the underlying health and viability of the project.

Then later it can have the project funding added …

The Business Case can have Project Funding added

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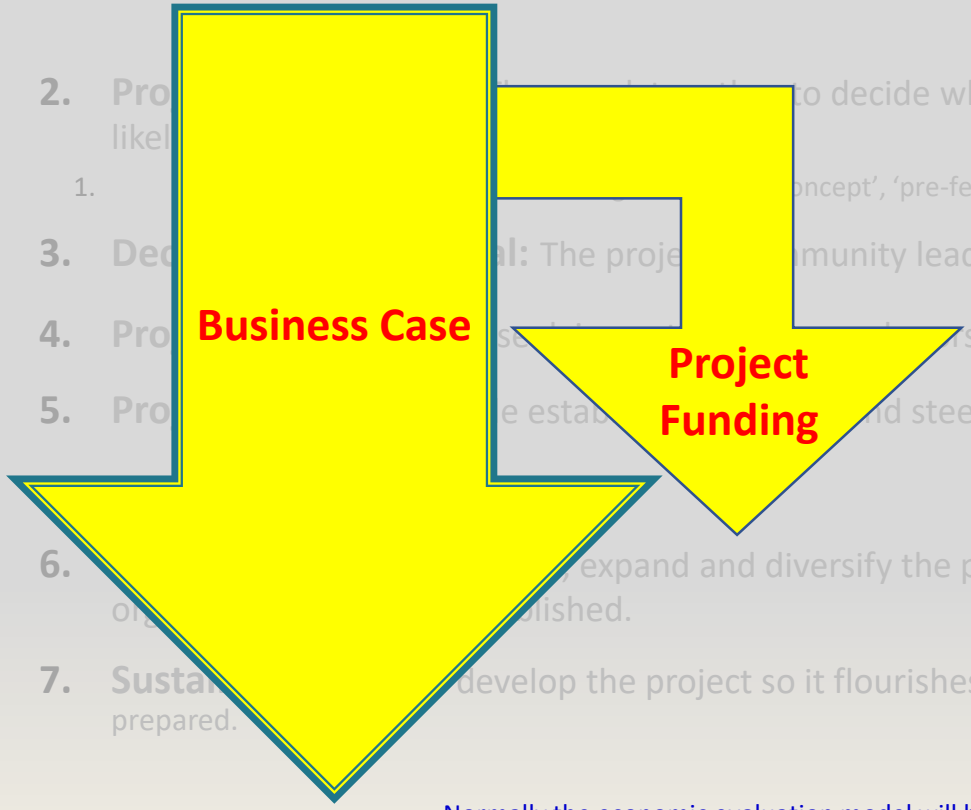

Normally the economic evaluation model will be in real terms (excluding inflation) whereas the funding sheets will be 'inflated' to dollars-of-the-day (nominal terms)

3. Accounting

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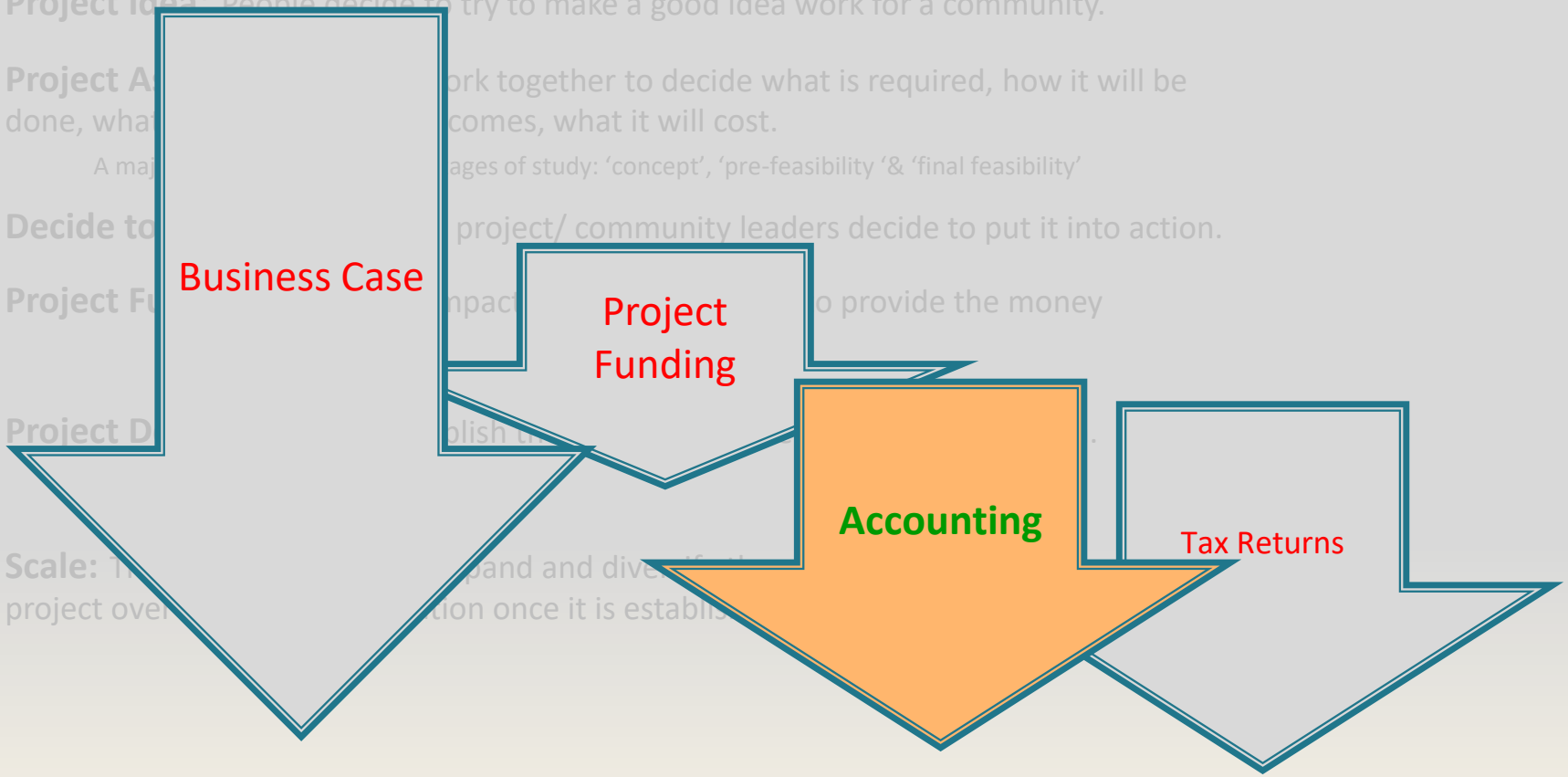


Accounting is important ...

Social Enterprises and Charities know very well that accounting is a critical activity.

1. **The social enterprise** gets an objective measure of the project's financial performance
2. **Donors** can see if their generosity is being suitably rewarded.
3. **Lenders and investors** can monitor the performance of the project and get more involved if things are starting to look difficult.
4. **Governments and communities** can monitor the project from their own perspectives.

They know that accounting is a long established global practice that has professional standards and practices in most countries around the world.

Inside a social enterprise or charity, any people who are unfamiliar with accounting might feel a little lost inside the workings. Some may just put it aside as someone else's domain. But key leaders should make themselves fully aware of what the accounts are saying and be taking actions.

After taking into account the resources invested in the past and liabilities expected in the future, **accounting assesses** ...

- how well the project has been performing over the past period (typically a month, quarter or year)
- how well it is likely to perform in the next period (month, quarter, year) as a 'budget' or as a 'forecast'

Remember: Accounting does not compete with economic evaluation and does not supersede it.
They run in parallel

Accounting uses matching and accruals ...

Unlike business modelling, it does not use cash as it is spent and received, but it **matches** sales in any period with all the costs in the past, present and future that were needed to produce those particular sales.

Here is an example – let's assume 55 units were produced but only 45 units were sold in the accounting year : -

Revenue & debtors

Accounting will compute the revenue that should be received from selling 45, whether or not the cash has actually been received by the project. (Anyone yet to pay is called a 'debtor')

Expenses & creditors

It then deducts the 'variable' expenses in producing those 45 units, even though 55 were actually produced. It uses these expenses whether some were paid in cash last year and whether some expenses will be paid out in cash next year. (Anyone yet to be paid by the project is called a 'creditor')

Overheads, general and administration

Accounting next deducts the 'fixed expenses' such as management pay, administration, marketing, rentals, warehousing, legal, environmental, social, community that match that accounting period .

Capital investments & Depreciation and amortisation

Accounting looks at purchases of assets in past years (such as equipment, facilities, rights) and allocates a portion of this money against the project's operations this year. This is called 'depreciation and amortisation'.

*In this example, a machine costing $1 000 was purchased a few years back. It should produce 500 units over its life. So the deduction for depreciation will be for those units sold = $1000/500 * 45 = $90*

Future liabilities

A similar calculation is made to allocate future costs, like closure, against project operations this year.

Income tax

It then deducts the income tax that would have been paid using all the calculations above. This can become rather tricky because Accounting and Tax Returns may use slightly different approaches. The tax computed by accounting may be out-of-phase with the actual tax paid for much of the project life. (Business modelling uses the actual tax paid)

Matching & Accruals are concepts that non-accountants can find puzzling and even baffling.

There is an explanation at: www.business.gov.au/info/run/finance-and-accounting/accounting/cash-vs-accrual-accounting

How does accounting differ from business modelling?

Data: Both use much the same data but in different ways

Time Periods: Business models compute from today (or some convenient near date) until the enterprise is definitely viable. Accounting usually computes over shorter time periods, such as the last month/year or the next month/year.

Cash: The business model considers only actual cash in and actual cash out. If money is paid out or received in any year then it is included in the evaluation – (but it does not include funding by lenders/sponsors or repayments). Accounting uses non-cash concepts , such as depreciation and amortisation, stockpile movements, accruals

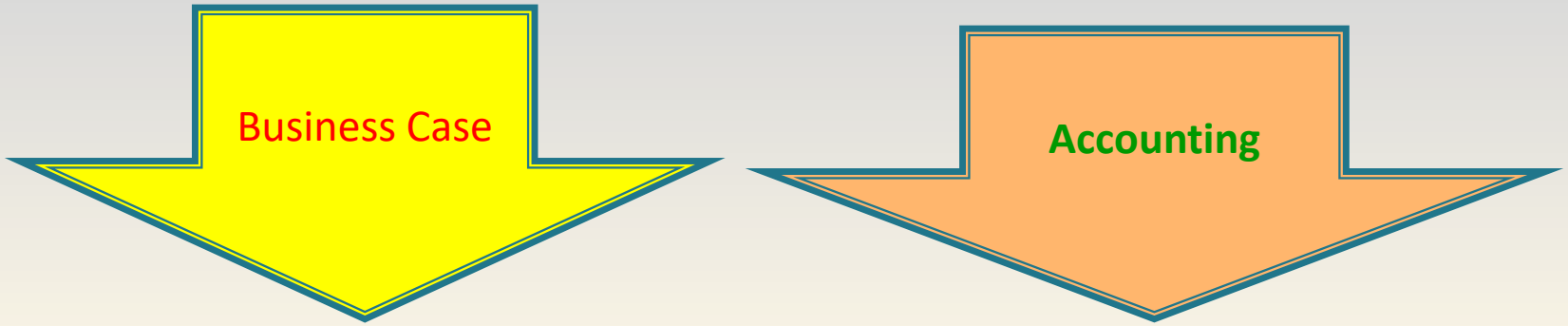
Matching: As described above, accounting begins with the revenue from selling goods/services and deducts the matching costs of producing those goods/services. Some of these costs may be paid in cash in the years before or after. This matching requires detailed computations of stockpile movements, depreciation, amortisation, future liabilities, etc. This is accrual accounting. Business modelling does not match costs with sales but uses actuals cash movements. For example if there was production but zero sales then the accounting costs would be zero, whereas the business model would include the actual cash spent on production.

Profit: Accounting computes a 'profit/loss' (or income) that may be quite different to the cash surplus/deficit. This means that in any year the project may be showing an accounting loss but be generating cash or vice versa.

Past expenditures: Business modelling ignores past investments/expenditure on the project (except when computing future tax benefits) whereas Accounting includes the portion of past investments/expenditures that was 'used up' in producing the goods/services sold in the period.

Money terms: Business modelling is best done in real terms (excluding inflation) whereas accounting is done in nominal terms (dollars of the day)

Standards and Governance: Accounting is strictly controlled by national and international standards and usually is done by a qualified Accountant. Business modelling sadly lacks those international standards and procedures (although the global mining industry is adopting the practices in this website). This means that social enterprises must be wary of self-anointed 'experts' in business modelling. It is why project leaders must insist that the business model be created by people prepared to follow the rigorous practices of this website.



The Business Case can have the Project Funding and preliminary Accounting added …

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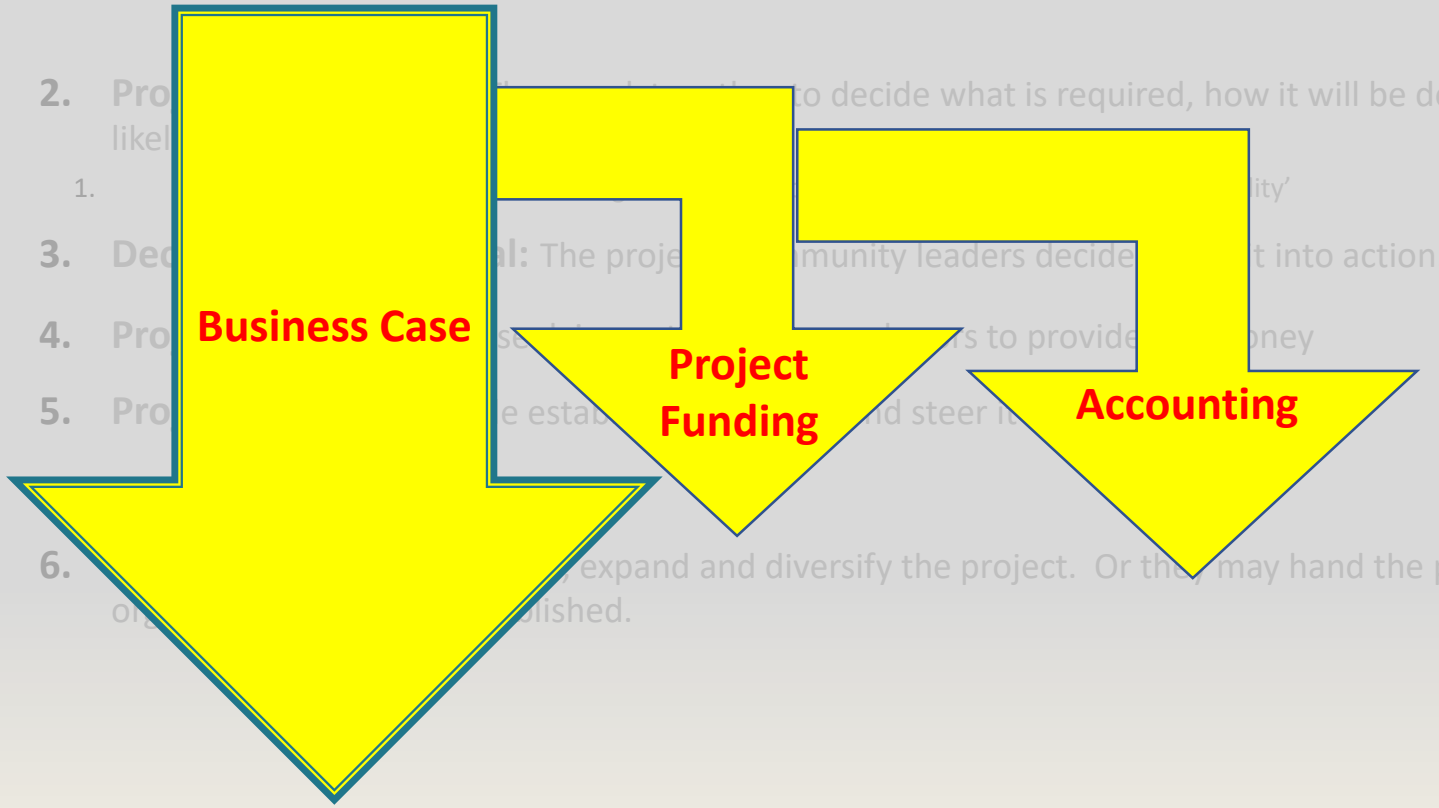
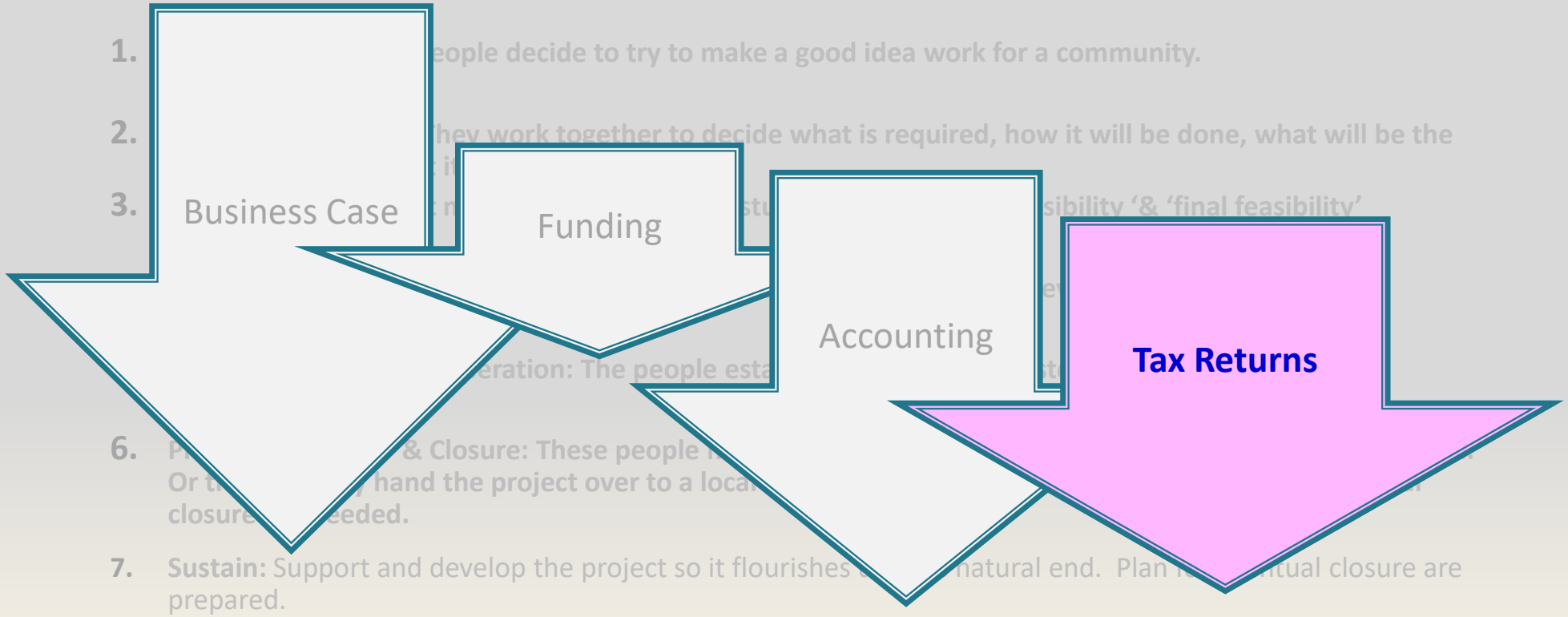


4. Tax Returns



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Q: How do tax returns differ from accounting?

A: Both use the same concepts but usually have slightly different rules.

Tax returns are for the past 12 month period .

Accounting can be for a month, a quarter, a year, several years.

Matching & Accruals are used by both

Accounting computes a **profit/loss or income** by deducting from the revenue the costs in earning that revenue including depreciation and amortisation and taxes.

Tax returns compute an **'assessable income'** by deducting from revenue, the costs in earning that income. Rather than using the same depreciation and amortisation as used in accounting, the tax return uses deductions for past investments as detailed in government legislation. Frequently these are different rates from accounting, but over the life of the project they should be broadly equal.

Nominal terms: Both tax returns and accounting will be computed in nominal terms (incl inflation)

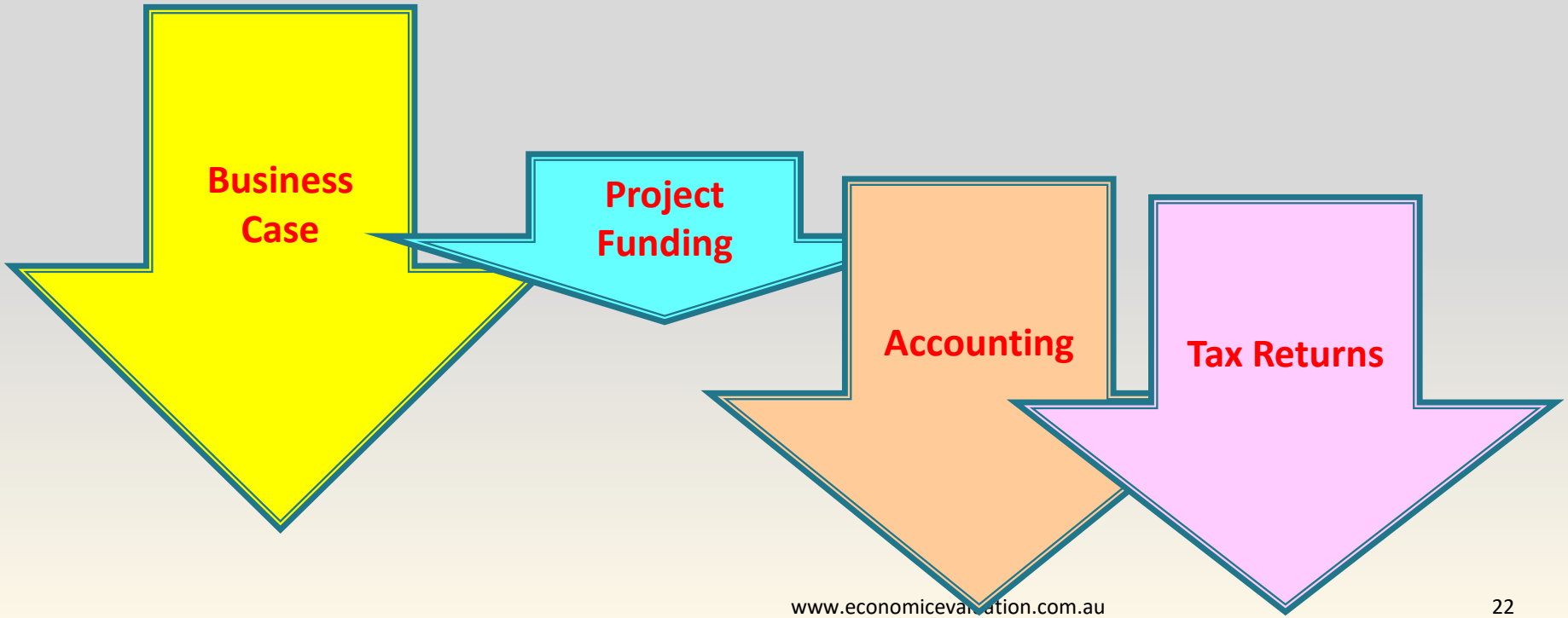
Governance: Like accounting, tax is strictly controlled,. The government sets out detailed computations to be followed. Tax returns usually are completed by a qualified Accountant or Tax Specialist.

When should the business case be initiated by the Project Leaders?

Some people running social enterprise projects and charity projects worry about losing control if they get the business case started. They prefer to keep their ideas bubbling and the project flowing and not get 'distracted' by the project's economics. When the project is more settled and better understood, they then prefer to get their accountant to 'look after the business modelling' – which they may regard as a distraction from the real challenges they think they face!

In reality, they are resisting a wonderful resource. They could be more in control, more powerful and more effective if they got one of their key staff or an external volunteer to begin the business case.

By initiating business modelling at the outset, these leaders can demonstrate they have a helicopter view of the project, have a pragmatic understanding of its viability and can steer it more effectively.



A quick comparison ...

	Economic Evaluation	Project Funding	Accounting & Tax
Target audience ...	Social Enterprise leaders	Investors & lenders	Project leaders, investors, lenders, community, government
Performed by ...	A practical, experienced professional who is positive and constructive	An experienced fundraiser	Qualified accountants and tax specialists
Purpose ...	To understand the health of the project, help steer the project and to have decisions made with complete awareness	To raise funds	To report accurately
Scope	Unlimited – fully investigate, select best configuration, optimise, improve, present findings, steer, assist.	Raise funds and understand the safety margins for repayments	Follow world-wide professional standards and procedures
Setting ...	A practical representation of what should happen in real life	← ditto	Re-arranging past and future spending so it matches the output in the period being assessed.
Funding included?	No – but the funding model can be attached.	Yes	Yes
Start date	Today/this year	Start of funding	The start of the period under assessment
Period examined	From today to viability	To completion of repayments	Usually one month or one year
Money	Real terms (before inflation)	Nominal terms including inflation	Nominal terms including inflation
Precision of calculations	Matched to its importance. For example, the computations of output, prices, costs, stocks and depreciation can be approximated where the impact on decision making is minor.	Tend to be exact but can be approximated where impact is minor	Computations are exact, detailed and so can be painstaking.
Cash or 'Accrual'	Cash - as spent and generated	Mainly cash	Accrual – matching as above

Glossary 1	
Business Evaluation	Assessing what resources are inputted against what benefits are generated to test the health/ viability of the project (before financing)
Project Funding	Getting sponsors, donors, investors and lenders to provide cash to fund the project
Accounting	A highly regulated way of assessing the performance of the project over a specified period given its present activity, past inputs and future liabilities
Tax	Extracting money from the project as entirely defined by government legislation - and which usually has parallels with accounting.
Real terms	Before applying inflation – example $2.50 today and still $2.50 in 5 years
Nominal terms or Dollars of the Day	*After applying inflation – example $2.50 today becomes $3.97 in 5 years*
Business model	A reproduction of the project in an Excel workbook that uses physical material flows and community benefits as its foundation
Sunk costs	Any cash spent in the past that is not included in the assessment. (but the benefit of these sunk costs in reducing income tax in the future is included.)
Matching and Accruals	The accounting concepts of matching the sales in any period with the expenses in the past, present and future to produce those sales; including depreciation and amortisation.
Depreciation & Amortisation	The accounting concepts of matching the sales in any period with the capital invested in the past and present to produce the particular units sold
Debtors	Entities that owe the project cash
Creditors	Entities to which the project owes cash

Glossary 2	
NPV	Net Present Value is how much the future returns from the project are valued at today. In theory, the social enterprise should be willing to take either this cash or the project today.
IRR	Internal Rate of Return is the return generating power of the project.
Payback	Payback is simply the number of years the project needs to operate to payback the cash invested up-front by the sponsors, donors, lenders and investors.