COURSE NOTES FOR

FUNDAMENTALS OF ACCOUNTING 2
FOR
MICROFINANCE INSTITUTIONS

DFID
Financial Sector
Deepening Project
Uganda

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Foreword

These course notes have been prepared in addition to the course notes in fundamentals of accounting one that were developed by Friends' Consult for FSDU.

The objective of these course notes is to link FAP 1 to FAP 2 and give detailed exercises and explanations for FAP 2. In order to understand the concepts of FAP 2, we introduced Chapter one – Overview of FAP one that was aimed at refreshing minds of the participants/ trainees before introducing concepts of FAP 2.

Generally, almost all trainees for FAP 2 must have attended FAP 1. However, we noted from our training experience that in order to understand concepts of preparing financial statements for MFIs we needed to use simpler examples from trading organizations, then at a later stage introduce MFI financial statements

We included all the necessary/basic accounting items necessary for preparation of MFI financial statements. We used simple illustration in all cases in order to bring out the accounting issues easily

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CHAPTER ONE

1.0 OVERVIEW OF FUNDAMENTALS OF ACCOUNTING ONE

1.1 Definition of Accounting

There are many definitions of accounting as was discussed in FAP 1, i.e., aaccording to the American Institute of Certified Public Accountants (AICPA), accounting is the "art of recording, classifying and summarizing in a significant manner and in terms of money transactions and events which are in part at least, of a financial character, and interpreting the results thereof".

Another authoritative definition of accounting is given by the American Accounting Association, (AAA), which defines accounting as "the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information".

3 key words in the definition are :(these were explained in detail in FAP 1)

- Measurement
- Communicating information
- Economic information

1.2 Types of Accounting

As discussed in FAP 1, there are various types of accounting, i.e.

Financial Accounting

Financial Accounting deals with historical records such as revenues that have either accrued or have been realized and expenses that have either been incurred or the obligation to incur them have been entered.

Cost Accounting

Cost accounting is a formal mechanism by means of which costs of products and services are ascertained and controlled. It is that branch of accounting dealing with classification, recording, allocation, summarization and reporting of current and prospective costs.

Management Accounting

Management accounting is that branch of accounting that provides information specifically to management for decision-making. The major difference between financial accounting and management accounting is that financial accounting is prepared for the benefit of many other groups apart from management; whereas management accounting is prepared primarily for the benefit of management.

Public Accounting

The Certified Public Accountants offer a variety of services such as auditing work, tax consultancy services, management advisory services like designing and installing accounting systems and budgetary procedures, etc to the public just like other professionals like lawyers, engineers, etc do. They belong to a governing body that regulates standards of performance.

Government Accounting

Government accounting emphasises recording and accountability of expenditures from exchequer account. It also emphasises budget discipline by spending according to amounts voted. The types of accounts to be maintained and reports to be prepared are spelt out in the financial regulations or accounting manuals. In Uganda, central government accountants have to refer to local government financial regulations.

Social responsibility Accounting

This is entirely a new phase in accounting development. It widens the scope of accounting by considering social effects of business activities as well as their economic effects.

1.3 Importance of accounting

- Provide information for decision making
- Helps in planning e.g. Budgets
- Helps in evaluation of the organisation
- Accounts make tax assessments easy
- May be a regulatory requirement
- Eases monitoring of debtors and creditors

Importance of accounting to MFIs

MFI is like any other organisation. Accounting helps MFIs in

- Decision making
- Evaluation of performance
- Tax assessment
- Monitoring debtors and creditors
- Regulatory in tier 4 MFIs and Saccos

1.4 USERS / INTERESTED PARTIES IN ACCOUNTING INFORMATION

Accounting information is very necessary to various parties if decisions are to be made accurately and rationally. These parties are broadly divided into 2 groups namely; (Refer to detailed explanation in FAP1)

1. **Internal Users**

a) **Management**

An organization's management team may comprise directors, senior executives, top managers etc, who run the organisation on behalf of the owners (shareholders). Accounting reports also indicate to management whether they are making profits or losses and whether they are in the right business.

b) **Employee and trade unions**

They need accounting for two major reasons;

- to support their agitation for salary and wage increments using accounting information (The profit and loss account)
- helps them assess and judge their job security

2. **External users**

a) **Share holders (investors)**

Existing shareholders or investors are interested in knowing how their business is performing i.e. whether the organization is well managed, expanding and whether they receive dividends.

b) **Creditors are individuals and financial institutions that extend credit to their customers or clients.**

Trade creditors (suppliers) are interested in getting paid for goods and services that they extend on credit while financial institutions like banks that extend loans to customers are interested in making sure that the loans are serviced and do not become non performing.

c) Government is another user of accounting information.

Though tax authorities, like the Uganda Revenue Authority, government collects tax revenue from companies and individuals for financing public expenditures. Tax authorities are interested in companies filing income tax returns for tax assessments.

d) Competitors

Competitors are interested in accounting information of firms in the industry with that so as to judge whether they are doing badly or fairly in comparison with other players in the same business. Competitors also require accounting information for market intelligence purpose to develop competitive strategies for beating other participants in the market.

e) The General public

The general public includes individuals and organization, which ensure that businesses make their profits in a socially acceptable manner without damage to the environment and consumers health.

1.5. Accounting policies/Concepts

Accounting principle

Accounting principles are basic ground rules, which must be followed when preparing financial accounts

Accounting policy

Accounting policies are defined as "the specific accounting bases selected and consistently followed by a business enterprise as being, in the opinion of management, appropriate to its circumstances and best suited to present fairly its results and financial position."

Accounting standard

Accounting standards are guideline statements or rules issued by professional accounting bodies governing accounting practice in areas or countries under their jurisdiction relating to how accounts should be prepared and presented.

Accounting standards override accounting policies chosen by management and in case of conflict between the two, accounting standards prevail.

Accounting base

Accounting Bases are accounting treatments. These are methods developed for applying fundamental concepts to financial transactions and items, for the purpose of financial accounts, and in particular;

- For determining the accounting periods in which revenue and costs should be recognized in the profit and loss account and;
- For determining the amounts at which material items should be stated in the balance sheet.

Accounting policies/Concepts

Financial Accounting Concepts represent the broad basic assumptions underlying the preparation of periodic financial accounts of organizations. These assumptions are also known as the Generally Accepted Accounting Principles or Conventions. They include the following:

Accounting principles

Detailed explanations of accounting principles were made in FAP 1 but due to the importance of these principles in accounting, they were recapped. There are two categories of accounting principles

- Fundamental Accounting principles
- Other Accounting principles

<u>Fundamental Accounting principles/concepts</u>

There are two fundamental accounting principles, i.e.

Going Concern concept

The going concern concept is the assumption that the organization or business for which the accounts are kept will exist for the foreseeable future.

Accrual concept

The accruals concept supports the going concern concept by providing that expenses should be deducted from the revenues with which they are associated.

<u>Other Accounting Concepts</u>

Business Entity Concept

Accountants treat business as distinct from those who own it.

Money Measurement Concept

Accounting records only those transactions, which are expressed, in monetary terms, though quantitative records are also kept.

Prudence Concept

Prudence means cautious or careful. The concept provides that if a loss is expected out of transactions that have already been entered into such loss should be provided for even if not yet realized.

Consistency Concept

The consistency concept ensures that results are comparable between periods by requiring the consistent application of methods from one accounting period to another..

Dual Aspect Concept

In financial accounting, each transaction has two aspects. For example if a business has acquired an asset, it must have resulted in one of the following:

i. Some other asset has been given up; or
ii. the obligation to pay for it has arisen;
iii. there has been, leading to an increase in the amount that the business owes the proprietor, or
iv. the proprietor has contributed money for the acquisition of the asset. The reverse is also true.

Realization concept.

This concept demands that accountants recognize income as earned only when a sale has been made and the customer has accepted the goods or services have been offered and enjoyed by the customers or where value has been created by a transaction and legal rights and obligations have resulted.

Matching concept.

This concept requires accurate matching of expenses against incomes by writing off only those costs or expenses that were incurred in the generating specific income for the period ended.

Materiality concept

It requires recognition of only material items and excluding immaterial or trivial items or matters. Information is immaterial if it is able to influence the decision.

Substance over form

It states that transactions and other events should be accounted for and presented in accordance with their substance and financial reality and not merely with their legal form.

Relevance concept

Accounting to this concept the overall message that the accounts are trying to relay may be obscured if too much information is presented. Accounting statements should contain only information that complies strictly with the specific requirements of the user. This concept is at times combined with materiality concept.

1.6 Accounting Equation

The whole of financial accounting is based upon a very simple idea. The accounting equation – if a firm is to be set up and start trading, then it needs resources. Assuming that it is the owner of the business who has supplied all of the resources: This can be shown as **Resources in the business = Resources supplied by the owner.** The amount of resources invested and claimed by the owners of the business is called Capital. The actual economic resources that are then used in the business to aid in the income generation process or facilitate operation are called assets. This means that when the owner supplies all the resources the equation above can be shown as: Assets = Capital.

It is usual that people other than the owner supply assets to a business. The amounts owing to these people are known as liabilities. Therefore the equation can be modified as follows:

Assets = Capital + Liabilities.

Each side of the equation will always have the same totals because it is the same thing.

Resources: What are they? = Resources: who supplied them?
(Assets) (Capital + Liabilities)

Comprehensive illustrations on the accounting equation were demonstrated in FAP 1.

1.7 Double Entry book keeping

Meaning of Double entry

In financial accounting, every transaction is recorded twice. Each transaction is understood to have two sides. Logically, there is a side that receives and another side that gives. For example, if a business has acquired an asset, it must result in one of the following:

i. Some other asset has been given up; or
ii. The obligation to pay for the asset has arisen; or
iii. There has been a profit, leading to an increase in the amount that the business owes the proprietor; or
iv. The proprietor has contributed money for the acquisition of the asset. The reserve is also true.

Key Rules of Double Entry

The three basic rules about recording transactions in a double entry system are:

(i) Debit the receiver and credit the giver;
(ii) Debit what comes in and credit what goes out
(iii) Debit all expenses (and losses) and credit all incomes (and gains)

Double entry system is accomplished by the use of ledger accounts. A ledger account has two sides namely debit and credit.

To summarize:

Debit	Assets	Credit
Increases		Decreases

Debit	Expenses or Losses	Credit
Increases		Decreases

Debit	Liabilities & Capital	Credit
Decreases		Increases

Debit	Incomes or Gains	Credit
Decreases		Increases

The nature of debit and Credit

A debit denotes:

(a) in the case of a person, that he has received some benefit against which he has already rendered some service or will render service in future. When a person becomes liable to do something in favour of the organization the fact is recorded by debiting that person's account;

(b) in the case of goods or properties, that the stock and value of such goods or properties has increased; and

(c) in the case of expenses, like salary or rent, that the firm has enjoyed some benefit or lost money.

ii. A credit denotes:

(a) in the case of a person, that some benefit has been received from him; entitling him to claim from the firm a return benefit in the form of cash or goods or service. When a person becomes entitled to money or money's worth for any reason, the fact is recorded by crediting him;

(b) in the case of goods or properties, that the stock and value of such goods or properties has diminished; and

(c) in the case of other accounts, i.e. commission, that the firm has made a gain.

iii. A debit balance shows that;

(a) money is owing to the firm; or

(b) the firm owns some property i.e. cash, goods etc..; or

(c) the firm has lost money or has incurred some expense.

iv. A credit balance shows that;

(a) money is owing to some person or

(b) the firm has given up so much property; or

(c) the firm has earned an income

1.9 ACCOUNTING CYCLE

This is the process, which is followed by accountants and bookkeepers in processing raw financial data into output information in form of financial statements.

The accounting process or cycle is described below;

Stage 1: Occurrence and documentation of business transactions

Business transactions or deals must be concluded first before anything is documented first or recorded.

Stage 2: Entering transactions into journals

Journals are books of original or prime entry. Information entered into journals is generated from the documents described above. There are several types of journals, the major ones include the general journal, sales, purchases journal and the cash book.

Stage 3: Posting of transactions to the ledger

The information, which has been entered into the journals, is posted to the ledger. A ledger is a book, which contains a collection of accounts. For ease of accounting, a ledger is sometimes sub divided into subsidiary ledgers.

Stage 4: Preparation of the Trial Balance

At the end of a period, normally a month, all accounts are closed or balanced off and the trial balance extracted. A trial balance is a list of debit and credit balances extracted form the ledger. Its purpose is to check the accuracy of the double entry.

Stage 5: End of year adjustments and preparation of financial statements

Financial statements are prepared from the trial balance. However, before this happens, the trial balance needs to be adjusted at the end of the year in order to make it up-to-date. (See chapter two below)

Stage 6. Analysis and interpretation of financial statements

This makes the financial statements user friendly. Lay people cannot read the figures in the financial statements and the jargon used by the accountants.

Detailed illustrations on recording of transactions in a typical MFI were demonstrated in FAP 1.

CHAPTER TWO

2.0 End of year adjustments

This is the fifth stage of the accounting cycle.

It is not possible to keep all accounts up to date at all times, therefore, accountants need to prepare adjustments at the end of every year so as the financial statements can represent a true and fair view of the state of affairs of the MFI or SACCO.

Examples of adjustments that are usually made at year-end include:

- Bad & doubtful debts
- Prepaid expenses and incomes
- Accrued expenses and incomes
- Corporation tax payable
- Depreciation and Asset schedule
- Proposed or paid dividends
- Transfers to reserves
- Adjustments for receivables and payables

2.1 Bad & doubtful debts

Some debtors/members who take loans fail to honour their obligations within credit period or fail to pay totally. Un collectable debts/loans should be written off through Profit &Loss.

Example 1 under end of year adjustments:

Kidevo sacco has Loans receivable totalling shs 5,000,000.5% of these loans are doubtful and are likely not to pay. You are required to pass the end of year adjustment.

Solution:

Bad & doubtful loans (B/L) = 5% x 5,000,000
= 250,000

Entries to pass
Dr B/L expense a/c 250,000
Cr Provision for B/L a/c 250,000

2.2 Writing off bad debts

Bad & doubtful debts become sometimes uncollectible. They must be written-off

Example 2 under end of year adjustments:

Kidevo sacco in example1 above has 95% certainty that 5% of its loans will not be paid

Required:
Pass the necessary adjustments

Solution:

Entries to pass
Dr Provision for B/L a/c 250,000
Cr Loans receivable 250,000

2.3 Direct write off of bad debts

There is no need to create provision accounts for small debtors'/loans' amounts. They should be written off directly through P&L

Example 3 under end of year adjustments:

Buhunga sacco runs an employee credit scheme. A loan of shs 8 million was given to Juliet, an employee but sufficient and appropriate evidence existed that she could not pay the loan.

Required:
Pass the appropriate adjustment

Solution:

Entries to pass
Dr P&L (Bad loan write off) 8,000,000
Cr Loans receivable (Juliet) 8,000,000

2.4 Increasing provision for Bad and Doubtful loans

At times, provisions for bad and doubtful loans have to be increased beyond current provisions due to increasing defaulting rate by members.

Example 4 under end of year adjustments:

The following information relates to Kacereere sacco. Current provision for Loan losses - shs 20,000,000.Expected increase is 10% of the current provision for Loan losses

Pass the necessary adjustment

Solution:

Expected increase = 10% x 20,000,000
= shs 2,000,000
Adjusted provision for L/L = shs 22,000,000

Entries:
Dr L/L expense a/c 2,000,000
Cr Provision for L/L a/c 2,000,000

2.5 Decreasing provision for B/D

When debtors start paying, and there's little doubt about amounts due from members being collected, provision for once high bad and doubtful loans can be reduced.

Example 5 under end of year adjustments:

Bukanga sacco had made a provision of shs 15,000,000 against Loan Losses (L/L).
Prospects show that provision for L/L has reduced by shs 4,000,000

Required:
Show the adjusting entries to be passed
Solution:

Entries to pass
Dr Provision for L/L 4,000,000
Cr L/L (P&L) 4,000,000

2.6 Bad and Doubtful loans previously written off

Bad and Doubtful loans previously written off as uncollectible can be recovered after several years

Accounting entries to be made are in 3 steps

Step1 – Reinstate the debtor/loan
Step 2 – Recognise receipt of cash or cheque
Step 3- Close the B/D Loan a/c through P&L

Example 6 under end of year adjustments:

Mutara sacco lent Martin, a member shs 40,000,000 .Martin failed to pay & disappeared and Mutara sacco subsequently w/o Martin as a Loan Loss.
After 6 years, Martin surfaced & paid Mutara sacco shs 40 million by cheque in full

Account for the shs 40 million

Solution:

Step 1 – Reinstate Martin as a debtor

Dr Loan's a/c (Martin) 40,000,000
Cr L/L recovered a/c 40,000,000

Step 2 – Recognise the cheque received

Dr Bank a/c 40,000,000
Cr Loan's a/c 40,000,000

Step 3 – Close the B/D recovered a/c through P&L

Dr L/L recovered a/c 40,000,000
Cr P&L a/c 40,000,000

2.7 Prepaid expenses

These are expenses paid in advance. They are expenses paid in one financial year but benefit another. Adjustments must be made for such prepaid expenses.

Example 7 under end of year adjustments:

Isingiro sacco paid rent of shs 8,000,000 for 18 months from 1/1/20X4 to 30/6/20X5

Required:
Record the adjusting entries for the entity as at 31/12/20X4

Solution:

Basic accounting assumption – rent paid accrues evenly over the 18 months i.e.

$$\frac{\text{Shs } 8{,}000{,}000}{18 \text{ months}} = \text{Shs } 444{,}445$$

Rent for 12 months = 444,445 x 12
= Shs 5,333,340

Prepaid rent = 8,000,000 – 5,333,340
= Shs 2,666,660

Entries to be passed

Dr Prepaid rent 2,666,660
Cr Rent expense a/c 2,666,660

Example 8 under end of year adjustments:

Mayuge sacco paid shs 400,000,000 for insurance covering 2 financial years. By the end of the year 31/12/20X5, insurance for one year had expired.

Record the adjusting entry as at 31/12/20X5

Solution:

Insurance for 1financial year = Shs 400,000,000 / 2 financial years
= Shs 200,000,000

Adjusting entries:

Dr Insurance expense 200,000,000
Cr Prepaid insurance 200,000,000

2.8 Accrued expenses

These are expenses incurred in one year paid in the next financial year. They are current liabilities to the MFI.

Example 9:

Asonkera sacco paid salaries of shs 15,000,000 for December 2005 in January2006.

Required:
Account for the transaction at the end of December 2005

Solution:

Dr Salaries expense 15,000,000
Cr Salaries accrued/payable15, 000,000

2.9 Prepaid income

Prepaid income is income received in advance. Income is received before it's earned
It's a current liability in the receiver's balance sheet

Example 10 under end of year adjustments:

Konye Keni Sacco's tenant paid rent amounting to shs 3,000,000 for 15 months

Required:

Prepare journal entries when rent was paid and journalise the entry at the year end

Solution:
When rent was paid

Dr Cash/Bank 3,000,000
Cr Prepaid income (rent) 3,000,000

At year end

Shs 3,000,000 = Shs 200,000 per month
15 months

Rent for 12 months = 200,000 x 12 months
= Shs 2,400,000

Adjusting entries:
Dr Prepaid income 2,400,000
Cr Earned income 2,400,000

2.91 Accrued income

This is income earned in one financial year but received in the following accounting period. It's a current asset in the balance sheet

Example 11 under end of year adjustments:

Kisaka & Co provided consultancy services at shs 5,000,000 to a client on 23rd November, 2005. The client was unable to pay until 15th January, 2006

Account for the transaction as at 31 December 2005

Solution:

Entries
Dr Consultancy fees receivable 5,000,000
Cr Consultancy income 5,000,000

2.92 Depreciation

Fixed Assets/Non Current Assets

These are assets acquired for retention by an MFI for the purpose of providing services to the business. They are not held for sale in the normal course of the business.

Entries passed on acquisition:

Dr Fixed Asset A/C
Cr Cash/Bank

Fixed asset depreciation

Non current Assets such as Machinery, Motor vehicles, fixtures and even buildings do not last for ever. If the amount received (if any) on the disposal of a Non current asset is deducted from the cost of buying it, the value of the non current asset can be said to have 'depreciated in value' by that amount over its period of usefulness to the business. For example, if a motor van was bought for Shs 20,000,000 and sold five years later for Shs 5,000,000= than its value has depreciated over the period of its use by Shs 15,000,000.

This is the only time that depreciation can be calculated accurately. That is, you can only estimate what it should be each year while the non current asset continues to be used.

Depreciation refers to reduction in value of assets (except land) due to wear & tear. It's also referred to as systematic allocation of the cost of the asset over its useful life. Depreciation must be provided for every financial year

Depreciation is an expense

Depreciation is that part of the original cost of a Non current asset that is consumed during its period of use by the business. The annual charge to the Income statement for depreciation is based upon an estimate of how much of the overall economic usefulness of a Non current asset has been used up in that accounting period. It is an expense for services consumed in the same way as expenses are incurred for items such as wages, rent or electricity. Because it is charged as an expense to the income statement, depreciation reduced profits.

Causes of depreciation

These can be divided up between physical deterioration, economic factors, the time factor, and depletion. Let us look at these in more details.

Physical Deterioration

(i) Wear and Tear

When a motor vehicle or machinery or fixtures and fittings are used they eventually wear out. Some last many years, others last only a few years. This is also true of buildings, although some may last for a long time.

(ii) Erosion, rust, rot and decay

Land may be eroded or wasted away by the action of wind, rain, sun and other elements of nature. Similarly, the metals in motor vehicles or machinery will rust away.
Wood will rot eventually; decay is a process which will also be present due to the elements of nature and the lack of proper attention.

Economic factors

These may be said to be the reasons for an asset being put out of use even though it is in good physical condition. The two main factors are usually **Obsolescence and inadequacy.**

(i) Obsolescence

This is the process of becoming out-of-date. For instance, over the years there has been great progress in the development of synthesis and electronic devices used by leading commercial musicians. The old equipment will therefore have become obsolete, and much of it will have been taken out of use by such musicians.

This does not mean that the equipment is worn out. Other people may well buy the old equipment and use it, possibly because they cannot afford to buy new up-to-date equipment.

(ii) Inadequacy

This arises when an asset is no longer used because of the growth and changes in the size of the business.

(iii) The Time factor

Obviously time is needed for wear and tear, erosion etc and for obsolescence and inadequacy to take place. However, there are Non current assets to which the time factor is connected in a different way. These are assets which have a legal life fixed in terms of years.

For instance, you may agree to rent some buildings for ten years. This is normally called a Lease. When the years have passed, the lease is worth nothing to you, as it has finished. Whatever you paid for the lease is now of no value.
A similar asset is where you buy a patent so that only you are able to produce something. When the patent's time has finished it then has no value. The usual length of life of a patent is sixteen years.

Instead of using the depreciation, the term **amortisation** is often used for these assets.

Depletion

Other assets are of wasting character, perhaps due to the extraction of raw materials from them. These materials are then either used by the business to make something else, or are sold in their raw state to other businesses. Natural resources such as mines, quarries and oil wells come under this heading. To provide for the consumption of an asset of a wasting character is called provision for **depletion.**

Provision for depreciation as an allocation of cost
Depreciation in total over the life of a non current asset can be calculated quite simply as cost less the amount receivable when the non current asset is put out of use by the business. This amount receivable is normally referred to as the **residual value** of an asset. If the item is bought and sold for a lower amount within the same accounting period, then the difference in value is charged as depreciation in arriving at the period's net profit.

Methods of calculating depreciation charges

The two main methods in use are the **straight line method** and the **reducing balance method**. Other methods may be used in certain cases, and some of them are covered later. Most accountants think that the straight line method is the one that is generally most suitable.

Choice of method

The purpose of depreciation is to spread the total cost of a Non current asset over the periods in which it is to be used. The method chosen should be that which allocates cost to each period in accordance with the proportion of the overall economic benefit from using the Non current asset that was expended during that period.

If, therefore, the main value is to be obtained from the asset in its earliest years, it may be appropriate to use the reducing balance method, which charges more in the early years. If, on the other hand, the benefits are to be gained evenly over the years, then the straight line method would be more appropriate.

The repairs and maintenance factor also has to be taken into account. One argument supporting this was mentioned in the last section.

Other methods of calculating depreciation

There are many more methods of calculating depreciation, some of which are used in particular industries, such as the hotel and catering industry.

Sum of the Years' Digits Method

This method provides for higher depreciation to be charged early in the life of an asset with lower depreciation in later years.

Double entry records for depreciation

Introduction

Now that you know what depreciation is and how it may be calculated in the Section below you'll learn how to make the appropriate entries for depreciation in the accounting books. You'll also learn how to make the appropriate period-end entries in the financial statements.

Recording Depreciation

The method now used involves maintaining each non current asset at its cost in the ledger account while operating another ledger account where the depreciation to date is recorded.
This account is known as the 'accumulated provision for depreciation account', often shortened to the accumulated depreciation account (or sometimes, confusingly known as the 'provision for depreciation account').

Let's look at how this method of recording depreciation is applied by first looking at the double entry required and then looking at it being used in the illustration 1. The depreciation is posted directly into the cumulative provision for depreciation account.

The double entry is:
Debit the Income Statement (i.e. deduct from the Gross profit)
Credit the accumulated provision for depreciation account

The disposal of a non current asset

Reasons for accounting entries
Upon the sale of a Non current asset, we will want to remove it from our ledger accounts. This means that the cost of that asset needs to be taken out of the asset account. In addition, the accumulated depreciation on the asset which has been sold will have to be taken out of the accumulated provision. Finally, the profit and loss on sale, if any, will have to be calculated and posted to the income statement.

When we change depreciation on a Non current asset we are having to make an informed guess. We will not often guess correctly. This means that, when we dispose off an asset, the amount received for it is usually different from our estimate.

Accounting entries

On the sale of a non current asset e.g. machinery, the following entries are needed:

A. Transfer the cost price of the asset sold to an assets disposal account (in this case a Machinery disposals account).

Debit Machinery disposals account
Credit Machinery account

B. Transfer the depreciation charged to the assets disposal account.

Debit: Accumulated provision for depreciation machinery
Credit Machinery disposals account

C. For the amount received on disposal

Debit Cash book
Credit Machinery disposal account

D. Transfer the difference (i.e. the amount needed to balance the Machinery disposals account) to the Income statement.

(i) If the machinery disposals account shows a credit balance (i.e. if more has been credited to the account then has been debited to it), there is a profit on the sale.

Debit Machinery disposals account
Credit Income Statement

(ii) If the Machinery disposals account shows a debit balance, there is a loss on sale:

Debit Income Statement
Credit Machinery disposals account

Change of depreciation method

It is possible to make a change in the method of calculating depreciation. This should not be done frequently, and it should only be undertaken after a thorough review. Where a change is made, if material, the effect of doing so upon the figures reported should be shown as a note to the financial statements in the year of change.

Disposal of assets

Disposal of assets can be done through:

1. Sale of Asset or
2. Write off

There are four sets of entries to be passed on disposal of an asset:

i. Write off of the fixed asset

Dr Fixed Assets Disposal A/C (Cost)
Cr Fixed Asset A/C (Cost)

ii. Write off of accumulated depreciation

Dr Accumulated Depreciation
Cr Fixed Asset Disposal A/C

iii. Recording of receipt of cash or cheque (Sales proceeds)

Dr Cash or Bank (Proceeds)
Cr Fixed Asset Disposal A/C

iv. Closing off the Disposal A/C to the Income Statement for a gain or loss on disposal.

Dr Disposal A/C
Cr Income Statement (Gain on disposal) or

Dr Income Statement (Loss on disposal)
Cr Disposal A/C

Revaluation of fixed assets

Assessing of Current Value of the Asset is done by professional valuers but can also be done by management

Valuer’s amount – Carrying amount = Revaluation amount

Entries to pass include:

Dr Fixed Asset (revaluation amount)
Cr Revenue Reserves

Other revaluation issues:

- Requirement of IFRS 16
- Revaluation can be reversed
- Revaluation losses
- Depreciation after revaluation
- Revaluation may increase useful life
- Treatment of revaluation reserves

Fully depreciated asset

A fully depreciated asset is an asset that is not depreciated any further but still exists with MFI. Maintain them at Nominal value, say, Shs 99 or Shs 1000

Fixed asset register

A non-current asset/ fixed asset is a record of details of all Fixed Assets or Non current asset.

Importance of a Fixed Asset register to an MFI

It helps to record:
- Nature of Asset(s)
- Serial Numbers of asset(s)
- Historical Cost of the asset(s)
- Date of acquisition of asset(s)
- Location/ user of the asset(s)
- Useful Life of the asset(s)
- Depreciation Details of the asset(s)

Fixed Asset Controls

- Regularly check them for existence
- Engrave assets with unique identification marks
- Determine the conditions
- Control Assets' movement
- Institute physical controls

Example12 under end of year adjustments:

The following information relates to Kadungulu sacco:
Equipment at cost – Shs 7,000,000
Its Kadungulu Sacco's policy to depreciate equipment at 25%

Show the adjusting entries

Solution:

Depreciation on equipment
= 25% x 7,000,000
= Shs 1,750,000

Entries:

Dr Depreciation exp a/c (Equipment) 1,750,000
Cr Acc Depreciation (Equipment) 1,750,000

2.93 Corporation tax

When draft accounts suggest a profit, a provision for tax must be made. MFIs are not liable to tax according to the Income Tax Act, CAP 340, Laws of Uganda.

Example 13 under end of year adjustments:

Assuming Kapelebyong sacco accounts suggest PBT of shs 5,000,000. Assume tax provision at 30% and show adjusting entries at year end

Solution:

Corporation tax = 30% x shs 5,000,000
= shs 1,500,000

Entries:

Dr P&L (Provision for corporation tax) 1,500,000
Cr Corp tax payable 1,500,000

2.94 Proposed dividends

Dividends are rewards to shareholders for contributions made. Dividends are proposed when an entity makes profits

Example 14 under end of year adjustments;

Team plc made PBT of shs 50,000,000 during the year and proposed dividends to shareholders at 15% of the profits

Show the adjusting entries at year end

Solution:

Proposed dividends
= 15% x shs 50,000,000
= shs 7,500,000

Entries:
Dr P&L appropriations a/c 7,500,000
Cr Proposed div payable 7,500,000

CHAPTER THREE

3.0 THE WORK SHEET

A Work Sheet is an extension of the Trial Balance

3.1 Components of a Work Sheet

i. Unadjusted Trial Balance
ii. Adjustments
iii. Adjusted Trial Balance
iv. Income Statement
v. Balance Sheet

Note:
It's not part of permanent accounting records or a formal Financial Statement

3.2 Objective of a Work Sheet

- Enables accountants make adjustments to figures in it
- Provides assurance of period-end accounting procedures
- Source document for formal Financial Statements
- Shows Debits and Credits in formal Financial Statements

3.3 Preparation of a Work Sheet

In order to understand the concepts of a work sheet, work sheets for trading companies were introduced before attempting an example of a worksheet for MFIs. MFI financial statements are unique and governed by CGAP guidelines or IAS 30.Therefore accountants for MFI who in most cases have little or no accounting knowledge need to understand accounting concepts right from the very basics using trading company examples and later MFI example

We request that physical worksheets specially designed for the workshop should be provided to participants.

3.4 Illustrations

Exercise 1 on preparation of work sheets using a trading company:

Using details in Exercise 1, prepare a Work Sheet for TK Company
(Note that this example is of a trading company intended for providing a simpler illustration on preparation of financial statements, given the nature of MFI accountants)

TK & Company Limited

Trial Balance as at 31 December 2003

	Dr. (Shs. 000)	Cr. (Shs. 000)
Cash at hand	2,000	
Cash at bank	4,000	
Land, cost	100,000	
Motor vehicle, cost	10,000	
Accumulated depreciation – Motor vehicle		2,000
Equipment, cost	20,000	
Accumulated depreciation – (equipment)		4,000
Stock 1st January (opening stock)	1,000	
Trade debtors	5,000	
Provision for bad debts		2,000
Trade creditors		3,000
Sales		200,000
Purchases	110,000	
Discount allowed	2,000	
Discount received		1,000
Purchases returns (return outwards)		5,000
Sales returns (returns inwards)	10,000	
Carriage inwards	6,000	
Salaries	8,000	
Salaries payable (accrued salaries)		15,000
Rent	1,800	
Electricity	7,000	
Bad debts	1,200	
Capital		26,000
Long term bank loan		30,000
	288,000	288,000

Information for adjustments at the end of the financial year

a) Closing stock at the end of the financial year was valued at Shs 20,000,000
b) Salaries of Shs 2,000,000 accrued or remained outstanding at the end of the year and was not recorded in the trial balance
c) Half of the rent paid if for the forthcoming financial year
d) Depreciate fixed assets by 20% on the cost at the end of the year
e) 20% of trade debtors are expected to default, a provision against bad debts should be made.

Required:

As the company's Accountants, prepare TK Company's worksheet

Solution

Reminders:

●T.B is a list of Debit and Credit balances extracted from ledgers
●Debit Balance-Total debits on A/C exceed total credits

●Bal b/f is on debit side while bal c/f is on credit side
●Credit Balance- Total credits on A/C exceed total debits
●Bal b/f is on credit side while bal c/f is on debit side
●All assets except bank overdrafts have debit balances
●All expenses and Drawings have debit balances
●All assets (except bank overdrafts) ,expenses and drawings appear on debit side of TB
●Accounts which should have credit balances include:
-Revenues/Incomes
-Capital & Reserves
-Liabilities
●TB checks accuracy of A/C
●Especially observance of double entry rule and arithmetic accuracy
●If TB fails to balance by an immaterial figure, introduce suspense A/C

<u>Errors not detected by TB</u>
-Errors of original entry
-Errors of Omission
-Errors of Commission
-Compensating errors
-Errors of Principle
-Complete reversal of entries

●Final accounts are prepared from adjusted TB
●A Work sheet is an extended TB
●Work sheet reflects year-end adjustments
●It shows whether Final accounts will balance

a) TK & Company Limited
General Journal showing adjusting entries on 31 December 2003

	Account Titles	Dr.	Cr.
1)	Stock 31/12/03	20,000,000	
	Trading A/C		20,000,000
2)	Bad debts	1,000,000	
	Provision for bad debts		1,000,000
3)	Prepaid rent	900,000	
	Rent expense		900,000
4)	Salaries expense	2,0000,000	
	Accrued salaries or salaries payable		2,0000,000
5)	Depreciation expense: Vehicle	2,000,000	
	Accumulated depreciation: Vehicle		2,000,000
6)	Depreciation expense: equipment	4,000,000	
	Accumulated depreciation equipment		4,000,000

b) TK & Company Limited
Work Sheet for the year ended 31 December 2003

Accounts	Trial balance		Adjustments		Adjusted trial Balance		Income statements		Balance sheet	
	Dr Shs 000	Cr Shs 000	Dr Shs 000	Cr Shs 000	Dr Shs 000	Cr Shs 000	Dr Shs 000	Cr Shs 000	Dr Shs 000	Cr Shs 000
Cash at hand	2,000				2,000				2,000	
Cash at bank	4,000				4,000				4,000	
Land, cost	100,000				100,000				100,000	
Motor vehicle, cost	10,000				10,000				10,000	
Accumulated depreciation – motor vehicle		2,000		2,000		4,000				4,000
Equipment, cost	20,000				20,000				20,000	
Accumulated depreciation – equipment		4,000		4,000		8,000				8,000
Stock 1st Jan (opening stock)	1,000				1,000		1,000			
Trade debtors	5,000				5,000				5,000	
Provision for bad debts		2,000		1,000		3,000				
Trade creditors		3,000				3,000				
Sales		200,000				200,000		200,000		
Purchases	110,000				110,000		110,000			
Discount allowed	2,000				2,000		2,000			
Discount received		1,000				1,000		1,000		
Purchases returns (returns outwards)		5,000				5,000		5,000		

[Solution cont'd]

Sales returns (returns inwards)	10,000				10,000		10,000			
Carriage inwards	6,000				6,000		6,000			
Salaries	8,000		2,000		10,000		10,000			
Salaries payable		15,000		2,000		17,000				17,000
Rent	1,800			900	900		900			
Electricity	7,000				7,000		7,000			
Bad debts	1,200		1,000		2,200		2,200			
Capital		26,000				26,000				26,000
Long term bank loan	-	30,000				30,000				30,000
	288,000	288,000								
Closing stock								20,000	20,000	
Pre-paid rent			900		900				900	
Depreciation expense (motor vehicle)			2,000		2,000		2,000			
Depreciation expense (equipment)			4,000		4,000		4,000			
NET PROFIT							70,900			70,900
TOTALS			9,900	9,900	297,000	297,000	226,000	226,000	161,900	161,900

c) TK & Company Limited
Income Statement for the year ended 31 December 2003

	Shs	**Shs**	Shs
Sales			200,000,000
Less: Sales returns			10,000,000
Net sales			190,000,000
Less: Cost of Goods sold			
Opening stock		1,000,000	
Add: Purchases	110,000,000		
Less: Purchases returns	5,000,000		
Net purchases		105,000,000	
Add carriage inwards		6,000,000	
Cost of goods available for sale		112,000,000	
Less: Closing Stock (31/12/03)		20,000,000	
Cost of goods sold			92,000,000
Gross profit			98,000,000
Add: Miscellaneous revenues/income			
Discount received			1,000,0000
			99,000,000
Less: Operating expenses			
Salaries (see note1)		10,000,000	
Electricity		7,000,000	
Rent (see note 2)		900,000	
Sales discount (see note 4)		2,000,000	
Bad debts (see note 3)		2,200,000	
Depreciation – Vehicle (note 5)		2,000,000	
- Equipment (note 5)		4,000,000	28,100,000
NET PROFIT			70,900,000

d) TK & Company Limited
Balance Sheet as at 31 December 2003

	Cost	**Acc depreciation**	**N.B.V**
FIXED ASSETS	**Shs**	**Shs**	**Shs**
Land	100,000,000	-	100,000,000
Motor Vehicle	10,000,000	4,000,000	6,000,000
Equipment	20,000,000	8,000,000	12,000,000
	130,000,000	12,000,000	118,000,000
Current assets (see note 7)			
Cash		2,000,000	
Bank		4,000,000	
Prepaid rent		900,000	
Trade Debtors	5,000,000		
Less: Provision for Bad debts	3,000,000	2,000,000	
Closing stock		20,000,000	
		28,900,000	
Less: Current Liabilities			
Creditors	3,000,000		
Accrued salaries	17,000,000	20,000,000	
Working capital or net current assets			8,900,000
Net assets			126,900,000
Financed by			
Capital			26,000,000
Add: net profit (see note 6)			70,900,000
Owner's equity			96,900,000
Long term liabilities			
Long term bank loan			30,000,000
CAPITAL EMPLOYED			126,900,000

Explanatory notes for TK & Company Limited

Note 1: Wages of 2,000,000= accrued. Whenever an expense accrues it must be added to that expense account figure already in the trial balance or created if it did not exist in the trial balance. In this case.

Wages as per trail balance	8,000,000
Add: accrued wages	2,000,000
Total to profit and loss account (income statement)	10,000,000

Accrued wages or wages payable must also be recoded under current liabilities in the balance sheet. In this case 2,000,000= accrued wages or wages payable appears in the balance sheet as a current liability

Note 2: Rent of 900,000= was prepaid. Because much as that rent was paid for the financial year ended 31/12/2003. It is for the following financial year commencing on 1/1/2004. This prepaid rent must be subtracted from rent paid. This is necessary to match expenses accurately against revenues and to apportion or charge expenses to the period they relate. In this case:

Rent as per trial balance	1,8000,000
Less: prepaid rent	900,000
Rent to charged in the profit and loss account or income statement	900,000

Any expense which is prepaid (paid in advance) must appear as a current asset in the balance sheet. In this example, a prepaid rent of shs 900,000 appears under current assets in the balance sheet.

Note 3: Additional provision equivalent to 20% of debtors to be made.

Additional provision	5,000,000 x 20% = 1,000,000=

This means that there were additional bad debts expense of 1,000,000 which must be added to the existing figure.

Bad debts as per trial balance	1,200,000
Add: Addition provision	1,000,000
Total bad debts figure to be taken to profit and loss account or income statement	2,200,000

Note 4: Sales discount could alternatively be subtracted from sales in arriving at net sales. If it is subtracted from sales, it should not again be charged as an operating expense. Likewise discount received could be subtracted from purchases and not treated as miscellaneous income.

Note 5: Depreciation is an operating expense though it is not a cash flow item. Depreciation of various years are accumulated and subtracted from the cost of the asset in deriving balance sheet book values.

<u>Calculation of depreciation</u>:

Motor Vehicle	10,000,000 x 20% = 2,000,000
Equipment	20,000,000 x 20% = 4,000,000

Note 6: The net profit figure inter-phases between the income statement and balance sheet. Net profit which is not distributed as dividends but ploughed back into the business (retained earnings) becomes a source of equity financing and is added to capital or put under shareholder's reserves in the "financed by" section of the balance sheet.

Note 7: Current assets are normally arranged in the balance sheet in the order of increasing liquidity or decreasing permanency. Stock is the least liquid or more permanent than other current assets and cash is the most liquid or least permanent. Therefore stock appears fist (on top) and cash last (bottom) in the arrangement of current assets. However, current assets for MFIs are arranged in the order of decreasing liquidity or increasing permanency because cash is the most important asset to MFIs.

Note 8: Provision for bad debts is offset from the debtors figure in the balance sheet. In this illustration, additional provision was made.

Provision for bad debts as per trial balance	2,000,000
Add: addition provision	1,000,000
Total provision for bad debts	3,000,000

Exercise 2 on preparation of work sheets using a trading company:

The bookkeeper of Seed Company Limited prepared the following trial balance for the financial year ended 31st March 1999.

	Dr.	**Cr.**
Cash at hand	800,000	
Cash at bank	2,500,000	
Debtors	3,000,000	
Stock	600,000	
Vehicle, cost	7,000,000	
Equipment, cot	5,000,000	
Purchases	4,000,000	
Wages	1,000,000	
Electricity	200,000	
Rent	700,000	
Bad debts	30,000	
Sales returns	50,000	
Sales discount	60,000	
Drawings	2,060,000	
Creditors		2,000,000
Income taxes payable		3,500,000
Purchases returns		500,000
Discount received		80,000
Sales		12,000,000
Provisions for bad debts 1/4/96		60,000
Capital		6,860,000
Long term bank loan		2,000,000
	27,000,000	27,000,0000

Information:

i. Closing stock at the end of the year was valued at 1,500,000=
ii. Additional provision of 1% of the debtors has to be made against bad debts on 31/3/99
iii. Of the rent paid 100,000 is for the financial year commencing on April 1st 1999.
iv. Wages of 300,000 accrued
v. Motor vehicle is to be depreciated by 20% and equipment by 10% on cost per annum.

Required

i. Provide journal entries for all adjustments
ii. Prepare Seed Co's income statement and balance sheet at the end of the financial year

Solution

a) Seed Co Limited
General Journal showing adjusting entries on 31 March 1999

	Account Titles	Dr.	Cr.
1)	Stock 31/3/99 Trading A/C	1,500,000	 1,500,000
2)	Bad debts Provision for bad debts	30,000	 30,000
3)	Prepaid rent Rent expense	100,000	 100,000
4)	Wages expense Accrued wages or wages payable	300,000	 300,000
5)	Depreciation expense: Vehicle Accumulated depreciation: Vehicle	1,400,000	 1,400,000
6)	Depreciation expense: equipment Accumulated depreciation equipment	500,000	 500,000

b) TK & Company Limited
Work Sheet for the year ended 31 December 2003

SEED Company worksheet

Accounts	***Trial Balance***		***Adjustments***		***Adjusted Trial Balance***		***Income Statement***		***Balance sheet***	
	DR	**CR**	**DR**	**CR**	**DR**	**CR**	**DR**	**CR**	**DR**	**CR**
Cash at hand	800,000				800,000				800,000	
Cash at bank	2,500,000				2,500,000				2,500,000	
Trade debtors	3,000,000				3,000,000				3,000,000	
Stock-1st Jan	600,000				600,000		600,000			
M/V at cost	7,000,000				7,000,000				7,000,000	
M/V Acc dep				1,400,000		1,400,000				1,400,000
Equipt-at cost	5,000,000				5,000,000				5,000,000	
Equipt-Acc dep				500,000		500,000				500,000
Prov for B/D		60,000		30,000		90,000				90,000
Sales		12,000,000				12,000,000		12,000,000		
Purchases	4,000,000				4,000,000		4,000,000			
Discount received		80,000				80,000		80,000		
Purchases returns		500,000				500,000		500,000		
Sales returns	50,000				50,000		50,000			
Sales discounts	60,000				60,000		60,000			
Drawings	2,060,000				2,060,000				2,060,000	
Wages	1,000,000		300,000		1,300,000		1,300,000			
Creditors										

		2,000,000				2,000,000				2,000,000
Rent	700,000			100,000	600,000		600,000			
Electricity	200,000				200,000		200,000			
Bad debts	30,000		30,000		60,000		60,000			
Capital		6,860,000				6,860,000				6,860,000
Long term bank loan		2,000,000				2,000,000				2,000,000
Income taxes payable		3,500,000				3,500,000				3,500,000
Accrued wages				300,000		300,000				300,000
Closing stock			1,500,000		1,500,000				1,500,000	
Trading account				1,500,000		1,500,000		1,500,000		
Prepaid rent			100,000		100,000				100,000	
Dep exp-M/V			1,400,000		1,400,000		1,400,000			
Dep exp-Equipt			500,000		500,000		500,000			
NET PROFIT							5,310,000			
Reserves										5,310,000
TOTALS	**27,000,000**	**27,000,000**	**3,830,000**	**3,830,000**	**30,730,000**	**30,730,000**	**14,080,000**	**14,080,000**	**21,960,000**	**21,960,000**

c) Seed Co Limited
Income Statement for the year ended 31/3/1999

	Shs	Shs	Shs
Sales			12,000,000
Less: Sales returns			50,000
Net sales			11,950,000
Less: Cost of Goods sold			
Opening stock		600,000	
Add: Purchases	4,000,000		
Less: Purchases returns	500,000		
Net purchases		3,500,000	
Cost of goods available for sale		4,100,000	
Less: Closing Stock (31/3/99)		1,500,000	
Cost of goods sold			2,600,000
Gross profit			9,350,000
Add: Miscellaneous revenues/income			
Discount received			80,0000
			9,430,000
Less: Operating expenses			
Wages (see note1)		1,300,000	
Electricity		200,000	
Rent		600,000	
Bad debts (see note 3)		60,000	
Sales discount (see note 4)		60,000	
Depreciation - Vehicle (note 5)		1,400,000	
- Equipment (note 5)		500,000	4,120,000
NET PROFIT			5,310,000

d) Seed Co Limited
Balance Sheet as at 31/3/1999

FIXED ASSETS	Cost Shs	Acc depreciation Shs	N.B.V Shs
Vehicle	7,000,000	1,400,000	5,600,000
Equipment	5,000,000	500,000	4,500,000
	12,000,000	1,900,000	10,100,000
Current assets (see note 7)			
Cash		800,000	
Bank		2,500,000	
Prepaid rent		100,000	
Trade Debtors	3,000,000		
Less: Provision for Bad debts	90,000	2,910,000	

Closing stock		1,500,000	
		7,810,000	
Less: Current Liabilities			
Creditors	2,000,000		
Income taxes payable	3,500,000		
Accrued wages	300,000	5,800,000	
Working capital or net current assets			2,010,000
Net assets			12,110,000
Financed by			
Capital			6,860,000
Add: net profit (see note 6)			5,310,000
			12,170,000
Less: drawings			2,060,000
Owner's equity			10,110,000
Long term liabilities			
Long term bank loan			2,000,000
CAPITAL EMPLOYED			12,110,000

Explanatory notes for Seed Company Limited

Note 1: Wages of 300,000= accrued. Whenever an expense accrues it must be added to that expense account figure already in the trial balance or created if it did not exist in the trial balance. In this case.

Wages as per trail balance	100,000
Add: accrued wages	300,000
Total to profit and loss account (income statement)	1,300,000

Accrued wages or wages payable must also be recoded under current liabilities in the balance sheet. In this case 300,000= accrued wages or wages payable appears in the balance sheet as a current liability

Note 2: Rent of 100,000= was prepaid. Because much as that rent was paid for the financial year ended 31/3/1999. it is for the following financial year commencing on 1/4/1999. This prepaid rent must be subtracted from rent paid. This is necessary to match expenses accurately against revenues and to apportion or charge expenses to the period they relate. In this case:

Rent as per trial balance	700,000
Less: prepaid rent	100,000
Rent to charged in the profit and loss account or income statement	600,000

Any expense which is p[repaid (paid in advance) must appear as a current asset in the balance sheet. In this example, prepaid rents of shs 100,000 appears under current assets in the balance sheet.

Note 3: Additional provision equivalent to 1% of debtors to be made.

Additional provision	3,000,000 x 1% = 30,000=
This means that there were additional bad debts expense of 30,000 which must be added to the existing figure.	
Bad debts as per trial balance	30,000
Add: Addition provision	30,000
Total bad debts figure to be taken to profit and loss account or income statement	60,000

Note 4: Sales discount could alternatively be subtracted from sales in arriving at net sales. If it is subtracted from sales, it should not again be charged as an operating expense. Likewise discount received could be subtracted from purchases and not treated as miscellaneous income.

Note 5: Depreciation is an operating expense though it is not a cash flow item. Depreciation of various years are accumulated and subtracted from the cost of the asset in deriving balance sheet book values.

<u>Calculation of depreciation</u>:

Vehicle	7,000,000 x 20% = 1,400,000
Equipment	5,000,000 x 10% = 500,000

Note 6: The net profit figure inter-phases between the income statement and balance sheet. Net profit which is not distributed as dividends but ploughed back into the business (retained earnings) becomes a source of equity financing and is added to capital or put under shareholder's reserves in the "financed by" section of the balance sheet.

Note 7: Current assets are normally arranged in the balance sheet in the order of increasing liquidity or decreasing permanency. Stock is the least liquid or more permanent than other current assets and cash is the most liquid or least permanent. Therefore stock appears fist (on top) and cash last (bottom) in the arrangement of current assets.

However, current assets for MFIs are arranged in the order of decreasing liquidity or increasing permanency because cash is the most important asset to MFIs.

Note 8: Provision for bad debts is offset from the debtors figure in the balance sheet. In this illustration, additional provision was made.

Provision for bad debts as per trial balance	60,000
Add: addition provision	30,000
Total provision for bad debts	90,000

CHAPTER FOUR

4.0 Financial Statements for MFIs and SACCOS

Financial statements for MFIs are different from those of a trading company. Preparation of Financial Statements for MFIs are governed by CGAP guidelines and IAS 30.

4.1 Illustrations

Exercise 1:

Use the information given below to prepare Financial Statements for Buwenge Sacco as at 31/12/2004

Account Name	DR	CR
LOANS & INVESTMENTS		
Short Term Loans	25,530,208	-
Allowance for loan losses	-	840,111
Investment in shares	100,000	-
Long Term investments and deposits	537,982,450	-
CASH & BANK BALANCES	-	-
Cash	43,326,600	-
Current DFCU Bank	2,062,150	
DEBTORS & PREPAYMENTS	-	-
Commissions & Interest receivable	22,786,950	-
Advance to Employees	12,263,988	-
Prepaid assets	10,198,754	-
PROPERTY, PLANT & EQUIPMENT	-	-
Equipments	4,136,850	-
Computer Units and Accessories	8,377,100	-
Electronic equipment	1,460,000	-
Office Furniture & Equipment	10,139,735	-
Accumulated depreciation on Electronic equipment	-	365,000
Acc depreciation Office Furniture & Equipment	-	1,675,313
Accumulated depreciation on Computer Sets	-	2,155,576
Accumulated depreciation on other equipment	-	1,392,240
SAVINGS & FIXED DEPOSITS	-	-
Regular saving	-	317,085,965
Short term time deposits	-	19,756,556
Savings and Time deposit	-	260,026,649
PAYABLES & ACCRUED EXPENSES	-	-
Interest payable on regular saving	-	6,250,502
Pay roll taxes payable (NSSF & PAYE)	-	1,834,000
Provision for audit fees	-	17,749,100
Loan Protection Fund	-	6,669,600
Other payables		425
EQUITY	-	-
Members shares	-	14,849,750
Statutory & Legal reserves	-	2,903,305
Retained earnings December 2003	-	5,267,803
DONATIONS	-	-

	DR	CR
Donations - SPEED	-	5,232,400
Donations – STROMME	-	6,394,740
Deferred STROMME Grant	-	6,273,450
Other Donations	-	550,000
INCOME	-	-
Commission on loan	-	4,924,370
Interest Received on Long & Short Term Bank Deposit	-	52,350,428
Income from Donors - STROMME Grants	-	2,726,550
	-	13,101,324
FINANCE COSTS	22,170,215	-
EMPLOYEE COSTS	25,091,513	-
Meeting expenses	1,685,334	-
DEPRECIATION	2,321,629	-
ADMISTRATIVE EXPENSES	-	-
Transportation Expenses	4,717,600	-
Audit and Supervision Expenses	651,225	-
Repairs and maintenance	508,850	-
Telephone/ Fax/ Internet Services Expense	2,049,400	-
Security, Utility and service exp	785,450	-
Stationery and Office Supplies Expense	3,284,950	-
Other admin expenses	4,797,903	-
Registration Fee	62,500	-
Provision for loan losses	1,278,029	-
Other expenses	2,605,774	-
Retained Earnings 2005	-	-
	750,375,180	750,375,180

Buwenge sacco
Balance sheet as at 31 December 2004

		2004	2003
		Shs 000	**Shs 000**
ASSETS	**Note**		
Loans and Advances	1	24,690,097	25,646,500
Short term investments	2	538,082,450	266,750,500
Cash and bank balances	3	45,388,750	118,465,000
Receivables (Debtors)	4	45,249,691	15,162,500
Property & Equipment	5	18,525,556	19,534,485
Other assets		-	9,404,518
TOTAL ASSETS		**671,936,544**	**445,081,303**
LIABILTIES			
Savings and time deposits	6	596,869,169	389,381,000
Accounts payable and accruals	7	32,504,051	28,726,500
Taxation payable		-	-
Total liabilities		**629,373,220**	**418,107,500**
EQUITY AND RESERVES			
Members' shares (Capital)		14,849,750	13,020,000
Statutory & Legal reserves		2,903,305	2,903,500
Donations (Deferred income)	8	18,450,590	5,782,500
Retained earnings December 2005	9	6,359,679	5,267,803
Total equity and reserves		**42,563,324**	**26,973,803**
TOTAL RESERVES AND LIABILITIES		**671,936,544**	**445,081,303**

Buwenge Sacco Income Statement for the Period Ended 31 December 2004

	Note	2004 Shs 000	2003 Shs 000
INCOME			
Interest income	10	52,350,428	20,578,000
Interest expense		-22,170,215	-14,348,500
Net interest income		30,180,213	6,229,500
Loan loss provision		1,278,029	-
Net interest income after provision for loan loss		**28,902,184**	**6,229,500**
Loan commission income		4,924,370	1,387,500
Other income		13,101,324	7,067,000
Total income		**46,927,878**	**14,684,000**
EXPENDITURE			
Administration expenses	11	19,464,077	16,888,995
Operating expenses	12	29,098,476	10,368,000
Total expenditure		**48,562,552**	**27,256,995**
Loss for the period		-1,634,675	-12,572,995
Grant income		2,726,550	12,362,020
Taxation		-	-
Net Profit for the period		**1,091,876**	**-210,975**
Transfer to reserves		**1,091,876**	**-210,975**

Note 1	**2004**	**2003**
LOANS & ADVANCES		
Short Term Loans	25,530,208	32,624,000
Allowance for loan losses	-840,111	-6,977,500
TOTAL	24,690,097	25,646,500

Note 2	**2004**	**2003**
SHORT TERM INVESTMENTS		
Investment in shares	100,000	639,500
Long Term investments and deposits	537,982,450	266,111,000
TOTAL	**538,082,450**	**266,750,500**
GRAND TOTAL	**1,125,545,093**	**584,794,000**

Note 3	**2004**	**2003**
CASH & BANK BALANCES		
Cash	43,326,600	61,948,000
Bank a/c	2,062,150	56,517,000
TOTAL	**45,388,750**	**118,465,000**

Note 4

RECEIVABLES (DEBTORS)	**2004**	**2003**
Commissions & Interest receivable	22,786,950	1,170,500
Advance to Employees	12,263,988	9,093,500
Prepaid assets	10,198,754	4,898,500
TOTAL	**45,249,691**	**15,162,500**

Note 5

PROPERTY, PLANT & EQUIPMENT

	Computer Units and Accessories	Electronic equipment	Office Furniture & Equipment	Total
Cost				
Bal b/f 1-1-2005	8,377,100	1,460,000	10,139,735	**19,976,835**
Additions	-	-	-	**-**
Bal c/f 31-12-2005	**8,377,100**	**1,460,000**	**10,139,735**	**19,976,835**
Depreciation				
Bal b/f 1-1-2005	1,182,022	195,325	496,913	1,874,260
Charge for the year	973,554	169,675	1,178,400	**2,321,629**
Bal c/f 31-12-2005	**2,155,576**	**365,000**	**1,675,313**	**4,195,889**
NBV				
1/1/2005	7,195,078	1,264,675	9,642,822	**18,102,575**
31/12/2005	6,221,524	1,095,000	8,464,422	**15,780,946**

Note 6

SAVINGS & FIXED DEPOSITS	**2004**	**2003**
Regular saving	317,085,965	276,764,000
Short term time deposits	19,756,556	-
Other Savings and Time deposits	260,026,649	112,617,000
TOTAL	**596,869,169**	**389,381,000**

S.48 Cooperative Societies Act requires that a Sacco shall transfer to reserves; 1% of the Sacco's turnover (Interest income) to Educational Fund

Note 7

PAYABLES & ACCRUED EXPENSES	**2004**	**2003**
Interest payable on regular saving	6,250,502	5,774,500
Pay roll taxes payable (NSSF & PAYE)	1,834,000	918,500
Provision for audit fees Payable	17,749,100	4,191,500
Loan Protection Fund	6,669,600	17,492,000
Other payables	850	350,000
TOTAL	**32,504,051**	**28,726,500**

Note 8

DONATIONS	**2004**	**2003**
Donations by SPEED	5,232,400	5,232,500
Donations - STROMME	6,394,740	-
Deferred STROMME Grant	6,273,450	-
Other Donations	550,000	550,000

TOTAL	**18,450,590**	**5,782,500**

Note 9	**2004**	**2003**
RETAINED EARNINGS		
Reserves-2003	5,267,803	
Profits-2004	1,091,876	
TOTAL	**6,359,679**	

Note 10	**2004**	**2003**
INCOME		
Commission on loan	4,924,370	2,775,000
Interest Received on Long & Short Term Bank Deposit	52,350,428	41,156,000
Income from Donors – STROMME Grants	2,726,550	-
Other non fin. Income	13,101,324	14,134,000
TOTAL	15,827,874	14,134,000

Note 11	**2004**	**2003**
ADMISTRATIVE EXPENSES		
Transportation Expenses	4,717,600	4,140,000
Audit and Supervision Expenses	651,225	-
Repairs and maintenance	508,850	815,000
Telephone/ Fax/ Internet Services Expense	2,049,400	3,591,500
Security, Utility and service exp	785,450	1,631,000
Stationery and Office Supplies Expense	3,284,950	1,598,000
Other admin expenses	4,797,903	3,739,500
Registration Fee	62,500	62,500
Other expenses	2,606,199	18,200,490
TOTAL	**19,464,077**	**33,777,990**

Note 12	**2004**	**2003**
OPERATING COSTS		
Employee costs	25,091,513	17,469,500
Meeting expenses	1,685,334	-
Depreciation	2,321,629	3,266,500
	29,098,476	**20,736,000**

CHAPTER FIVE

5.0 Control Accounts

A Control account is a summary account, also referred to as "total" account. The balance on the Control account should reconcile to individual ledgers

5.1 Examples of Control Accounts:

-Debtors (Sales) Control Account
-Creditors (Purchases) Control Account
-Savings Control Account
-Loans Control Account

Debtors and Creditors control accounts are for trading companies while the savings and Loan control accounts are specifically for Micro Finance Institutions.

5.2 Importance of Control Accounts

- Location of errors
- Detection of fraud
- Enhancing Management Efficiency
- Determination of Credit sales & Credit purchases
- Entries in Control Accounts

<u>Location of Errors</u>

Balance on control account should reconcile to individual subsidiary ledgers.
The two will not reconcile if errors exist.

<u>Detection of Fraud</u>

It's easy to detect manipulation of accounts under control of senior official.
Non reconciliation of the control accounts and individual ledgers is an indicator of fraud

Control accounts strengthen internal control

<u>Enhancing Management Efficiency</u>

Creditors and debtors balances can be obtained at first glance. This saves time

<u>Determination of Credit sales & Credit purchases</u>

These figures always miss in single entry and incomplete records, and Receipts & Payments accounts.

Credit sales and purchases can be obtained from Control Accounts

<u>Entries in Control Accounts</u>

Control accounts exist for other transactions and records

5.3 Illustrations

Example on control accounts:
Use the given information to draw up Debtors' and Creditors' control accounts for Katakwi Sacco

Debtors' bal 1/1/05		4,000,000
Creditors' bal 1/1/05		2,500,000
Cash paid to suppliers		16,000,000
Cash received from debtors		25,000,000
Credit purchases		17,000,000
Discount received		500,000
Bad debts written off		100,000
Sales returns		200,000
Purchases returns		300,000
Debtors cheque dishonoured		150,000
Discount allowed		700,000
Credit sales		30,000,000

You are required to draw up debtors and creditors control accounts

Control Accounts-Debtors control

Bal b/f		4,000,000
Debtors cheque		150,000
(Dishonoured)		30,000,000
Credit sales		34,150,000
Cash		25,000,000
Bad debts written off		100,000
Sales returns		200,000
Discount allowed		700,000
Bal c/d		8,150,000

Control Accounts-Creditors control

Cash paid to suppliers		16,000,000
Discount received		500,000
Purchase returns		300,000
Bal c/d		2,700,000
		19,500,000
Bal b/d		2,500,000
Credit purchases		17,000,000
		19,500,000

You are required to draw up debtors and creditors control accounts

Illustration of Savings control Account

Procedure:

i. Divide the Savings ledgers into batches of sub ledgers
ii. Post daily withdrawals & deposits to pass books & Ledgers
iii. Summarise transactions that belong to each ledger on a day/transaction sheet

Individual Ledgers	**Summary-Control a/c**
10001 Member xxx	
10002 Member xxx	
10003 Member xxx	

Day/Transaction sheet
Date 12/07/2006 Ledger No……2……..

Account	**Particulars**	**Debit**	**Credit**
202	Turyamureba	700,000	
403	Royal Complex		3,000,000
756	Otto (U) Ltd	1,000,000	
785	Mukasa		500,000
TOTAL		**1,700,000**	**3,500,000**

Control A/c Savings Ledger 2

Date	**Details**	**Debit**	**Credit**	**Balance**
11/03/2006	Balance b/f			12,000,000
12/03/2006	Day transaction	1,700,000	3,500,000	13,800,000
E.t.c				

CHAPTER SIX

6.0 Key Performance Measures

6.1 Examples of Key performance measures

- Trend analysis
- Ratio analysis
- Comparative statement analysis
- Inter-Firm analysis

6.2 Trend Analysis:

What is Trend Analysis?

It's the analysis of direction of changes over a period of years, or comparison of financial ratios over a period
Trend analysis is also called "trend-percentage method"

6.3 Ratio Analysis:

What is Ratio Analysis?

Indicated quotient of two mathematical expressions, or relationship between two or more accounting figures, expressed mathematically

In order to understand the concepts of financial ratios, an illustration for trading companies was introduced before attempting an example on financial ratios for MFIs. MFI financial ratios are unique. Therefore accountants for MFI who in most cases have little or no accounting knowledge need to understand accounting concepts right from the very basics using trading company examples and later MFI example

6.31 Types of Ratios for a trading company:

a) Liquidity ratios
b) Leverage ratios
c) Activity ratios
d) Profitability ratios

a) <u>Liquidity ratios:</u>

Liquidity ratios measure firm's ability to meet current obligations

Examples of liquidity ratios include,

i. Current ratio
ii. Quick ratio

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current Liabilities}}$$

$$\text{Quick ratio} = \frac{\text{Current assets} - \text{Inventories}}{\text{Current Liabilities}}$$

b) <u>Leverage Ratios:</u>
Leverage ratios show proportions of debt and equity in financing the firm's assets

Examples:

i. Debt ratio
ii. Debt – Equity ratio
iii. Interest cover

$$\text{Debt ratio} = \frac{\text{Total Debt}}{\text{Capital employed}}$$

$$\text{Debt – equity ratio} = \frac{\text{Capital employed}}{\text{Net Worth}}$$

$$\text{Interest cover} = \frac{\text{EBIT}}{\text{Interest}}$$

c) Activity Ratios:

They reflect the firm's efficiency in utilising its assets

Examples:

i. Inventory turnover
ii. Debtors' turnover
iii. Asset turnover

$$\text{Inventory turnover} = \frac{\text{Cost of goods sold}}{\text{Average inventory}} \text{ or}$$

$$\frac{\text{Sales}}{\text{Inventory}}$$

$$\text{Days of inventory holdings} = \frac{\text{Inventory}}{\text{Sales}} \times 365$$

d) Profitability ratios:

These measure the overall performance and effectiveness of the firms

Examples:

i. Gross and Net Profit Margins
ii. Return on investment (R.O.I)
iii. Earnings Yield

$$\text{Gross Profit Margin} = \frac{\text{Gross Profit}}{\text{Sales}}$$

$$\text{Net Profit Margin} = \frac{\text{Net Profit}}{\text{Sales}}$$

$$\text{Return on investment} = \frac{\text{EBIT}}{\text{Total Assets}}$$

$$\text{Earnings Yield} = \frac{\text{Earnings per share}}{\text{Market value per share}}$$

6.32 illustrations

Example on financial ratios for trading companies:

Using information given, prepare,
Trend Analysis
Key financial ratios for 2004 for HYT Company Ltd

	2003	2004
Sales	2,338,900	2,825,690
Cost of goods sold	1,929,040	2,322,800
Gross Profit	409,860	
Selling & admn exp	239,720	262,100
Operating income	170,140	240,790
EBIT	185,380	266,170
Interest	59,840	124,980
Provision for tax	41,790	30,000
Profit after tax	83,750	111,190
Share capital	225,000	225,000
Reserves	286,130	357,950
Net worth	511,130	582,950
Long term debentures	-	75,750
Others	199,870	285,900
Total Long term debt	199,870	361,650
Short term borrowing		
Total borrowing	442,920	641,390
Capital employed	642,790	1,003,040
Total non current assets	1,153,920	1,585,990
Total current assets (incl. inventories)	546,700	663,620
	866,080	1,404,550
Inventories	476,280	778,890
Debtors	253,160	340,610
Current Liabilities	258,860	482,180

Solution:

a) Liquidity Ratios:

Current Ratio = $\frac{1,404,550}{482,180}$

= 2.9:1

Quick Ratio = $\frac{1,404,550 - 778,890}{482,180}$

= 1.3:1

b) Leverage Ratios:

Debt Ratio = $\frac{1,003,040}{1,585,990}$

= 0.63

D/E Ratio = $\frac{1,585,990}{582,950}$

= 2.7

Interest cover = $\frac{266,170}{124,980}$

= 2.13 times

c) Activity Ratios:

Inventory turn over = $\frac{2,322,800}{778,890}$

= 2.98 times

Debtors turn over = $\frac{2,825,690}{170,305}$

= 16.6 times

Note:

Average debtors = 340,610/2

= 170,305

Asset turn over = $\frac{2,825,690}{(663,620 + 1,404,550)}$

= $\frac{2,825,690}{2,068,170}$

= 1.37 times

d) Profitability ratios

Gross Profit = $\frac{502,890}{2,825,690}$

= 0.178 or 17.8%

Net Profit margin = $\frac{111,190}{2,825,690}$

= 0.039 or 3.9%

Return on Investment = $\frac{266,170}{2,068,170}$

= 0.129 or 12.9%

Trend Analysis:

	2003	2004
Sales	100	$\frac{2,825,690}{2,338,900} \times 100$ = 120.8
EBIT	100	$\frac{266,170}{185,380} \times 100$ = 143.6

PAT 100 $\frac{111{,}190}{83{,}750} \times 100$

= 132.8

Current assets 100 $\frac{1{,}404{,}550}{866{,}080} \times 100$

= 162.2

2003 2004

Current Liabilities 100 $\frac{482{,}180}{258{,}860} \times 100$

= 186.3

Fixed assets 100 $\frac{663{,}620}{546{,}700} \times 100$

= 121.4

Total assets 100 = $\frac{(663{,}620 + 1{,}404{,}550)}{(546{,}700 + 866{,}080)}$

= $\frac{2{,}068{,}170}{1{,}412{,}780}$

= 146.4

Net Worth 100 = $\frac{582{,}950}{511{,}130} \times 100$

= 114.1

6.4 Financial ratios for MFIs:

Financial ratios for MFIs are different from those of trading companies for instance, MFIs do not have items like inventory and taxation.

Example on financial ratios for MFIs:

Using the financial information of Rubanda Kiizi sacco, let's prepare financial ratios for the sacco

Financial Ratios for Rubanda Kiizi sacco

		2005	2004
	Liquidity ratios		
1	Current ratio		
	Current assets	90,638,441	133,627,500
	Current Liabilities	32,503,201	28,726,500
	Current assets/Current Liabilities	3	5
2	Operational self sustaining ratio		
	Incomes	46,927,878	14,684,000
	Operational expenses	29,098,476	10,368,000
	Incomes/Operational expenses	2	1
3	Interest cover		
	Interest income	52,350,428	20,578,000
	Interest expense	22,170,215	8,119,000
	Interest income/Interest expense	2	3
4	Loans Vs Member deposits		
	Loans	24,690,097	25,646,500
	Total deposits	596,869,169	389,381,000
	Loans/Total deposits (%)	4	7
5	Debt/Member capital ratio		
	Debt	-	-
	Member share capital	14,849,750	13,020,000
	Debt Vs Member share capital (%)	-	-
6	Provision for loan losses/Short term loans		
	Provision for loan losses	1,278,029	-
	Short term loans	25,530,208	32,624,000
	Ratio (%)	5	-
7	Profitability V s Member deposits		
	Profits	- 1,634,250	- 12,572,995
	Member deposits	596,869,169	389,381,000
	Profits/Member deposits (%)	- 0	- 3
8	Profit vs Assets		
	Profit before interest & tax	1,092,301	- 210,975
	Capital employed	671,936,544	445,081,303
	PBIT/Capital employed	0	- 0
8	Cash vs total deposits		
	Cash	45,388,750	118,465,000
	Total deposits	596,869,169	389,381,000
	Cash/total deposits	0	0

CHAPTER SEVEN

7.0 Bank Reconciliation

Bank Reconciliation is the process of bringing into agreement the balance as per cash book (bank column) and the balance as per bank statement

7.1 importance of Bank Reconciliation

It strengthens an organisation's internal control system, and
Leads to accuracy in records

7.2 Reasons for discrepancy between cash book and bank statement balances

- Direct debits e.g. bank charges, standing orders
- Direct credits e.g. interest received
- Un presented cheques
- Un credited cheques
- Clerical errors
- Dishonoured cheques
- Unrecorded items (intentional)

7.3 Reasons for dishonouring a cheque by a bank

- Insufficient funds (R/D)
- Amount in words and figures differ
- Signature on cheque different from specimen
- Cheque is stale
- No counter signature on alterations in words and figures
- No account title on cheque
- Payee's identity doubted
- Payment vouchers not attached (if a BoU cheque)

7.4 Methods of Bank Reconciliation

i. Cash book balance adjusted towards bank balance
ii. Bank balance adjusted towards cash book balance

7.5 Illustrations

Example 1 on preparation of bank reconciliation statements:

The following is a cashbook and bank statement for Mushanga Sacco for December 2005
You are required to prepare a bank reconciliation statement for Mushanga Sacco for December 2005.

Date	**Details**	**Amount**	**Date**	**Details**	**Amount**
12-Jan	Bal b/f	80,000,000	7/12	Moses	32,000,000
12-Feb	Joel	60,000,000	12-Aug	Patra	40,000,000
12-Oct	Maria	24,000,000	12-Nov	Pam	30,000,000
14/12	Henry	10,000,000	17/9	Otto	14,000,000
28/12	Jack	4,000,000	28/12	Jim	6,000,000
16/12	Jane	4,000,000	30/12	Jill	2,000,000
28/12	Pat	34,000,000	30/12	Stella	1,000,000
30/12	Kim	13,000,000	30/12	Peter	4,000,000
30/12	Sarah	2,000,000		Bal c/f	94,000,000
Total		227,000,000			227,000,000

Note:

A cheque written to Jim on 28th December 2005, and one received from Jane and banked on 16th December 2005 were dishonoured by the bank.

Solution:

Method 1 – Adjusting cash book towards bank statement balance

Adjusted cash book

Details	**Amount**	**Details**	**Amount**
Bal b/f	94,000,000	Jane	4,000,000
Lillian	18,000,000	Brenda	2,000,000
Grace	16,000,000	Bank charge	200,000
Jim	6,000,000		
(Dishonoured cheque)		Bal c/f	127,800,00
Total	134,000,000	Total	134,000,000

Bank reconciliation for Mushanga Sacco for the month of December 2005

	Shs	Shs
Bal as per adjusted cash book		127,800,000
Add: un presented cheques		
Jack	4,000,000	
Jill	2,000,000	
Stella	1,000,000	
Peter	4,000,000	11,000,000
		138,800,000
Less: un credited cheques		
Pat	34,000,000	
Kim	13,000,000	
Sarah	2,000,000	49,000,000
Bal as per bank statement		89,800,000

Method 2:

Bank statement balance adjusted towards the cash book balance

	Shs	Shs
Bal as per bank statement		
Add: Direct debits		
Brenda	2,000,000	
Bank charges	200,000	2,200,000
Un credited cheques:		
Less: Direct credits		
Lillian	18,000,000	
Grace	16,000,000	34,000,000
Unpresented cheques:		
Jack	4,000,000	
Jill	2,000,000	
Stella	1,000,000	
Peter	4,000,000	11,000,000
Dishonoured cheque		
Jim	6,000,000	51,000,000
Bal as per cash book		94,000,000

Example 2 on preparation of bank reconciliation statements:

From the following information, prepare a bank reconciliation statement for Gulu Sacco

Cheque Number	**Amount (shs)**
15	500,000
20	1,200,000
25	700,000
30	400,000
32	3,000,000
40	600,000
45	2,500,000
50	1,500,000

List of uncredited cheques as at 31 December 2002

Cheque Number	**Amount (shs)**
101	2,400,000
83	100,000
163	900,000
75	1,400,000
105	250,000

January 2003 Cash book (Bank column) for Gulu Sacco

Details	Amount Shs'000	Details	Amount Shs'000
Bal b/f	4,650	Cheque No 60	2,500
Cheque No 204	1,500	Cheque No 61	1,400
Cheque No 310	2,800	Cheque No 62	300
Cheque No 802	4,000	Cheque No 64	700
Cheque No 740	600	Cheque No 65	2,600
Cheque No 150	2,000	Cheque No 66	200
Cheque No 610	1,500	Cheque No 68	1,000
Cheque No 550	3,200	Cheque No 69	7,200
Cheque No 440	1,900	Cheque No 70	3,000
Cheque No 320	400	Cheque No 71	2,200
Cheque No 280	5,000	Cheque No 72	100
Cheque No 900	6,000	Cheque No 73	800
Cheque No 260	5,500	Bal c/f	18,350
Cheque No 850	1,300		
Total	**40,350**	**Total**	**40,350**

January 2003 Bank Statement for Gulu Sacco

Details	Debit Shs'000	Credit Shs'000	Balance Shs'000
Bal b/f			10,000
Cheque No 25	700		9,300
Cheque No 32	3,000		6,300
Cheque No 15	500		5,800
Cheque No 105		250	6,050
Cheque No 163		900	6,950
Cheque No 204		1,500	8,450
Cheque No 310		2,800	11,250
CM		1,000	12,250
Cheque No 60	2,500		9,750
Cheque No 61	1,400		8,350
Cheque No 64	700		7,650
Cheque No 40	600		7,050
Cheque No 802		4,000	11,050
Cheque No 740		600	11,650
Cheque No 75		1,400	13,050
Cheque No 66	200		12,850
Cheque No 68	1,000		11,850
Cheque No 150		2,000	13,850
Cheque No 30	400		13,450
Cheque No 610		5,100	18,550
CM		500	19,050
Cheque No 70	3,000		16,050
Cheque No 280		5,000	21,050
Cheque No 69	2,700		18,350
Ledger fee	50		18,300
Commission	150		18,150
Interest		100	18,250

Note:

Cheque No 440 and 65 were dishonoured by the bank and returned together with the bank statement

In case of any mistakes in figures, they must have arisen due to mis-recording of the cashbook.

Solution:

Method 1 – Adjusting cash book towards bank statement balance

Adjusted cash book

Details	**Amount Shs 000**	**Details**	**Amount shs 000**
Bal b/f	18,350	Ledger fee	50
CM	1,000	Commission	150
Mistake on cheque No 610	3,600	Dishonoured cheque	1,900
CM	500		
Interest	100		
Dishonoured cheque No 65	2,600		
Mistake on Cheque No 69	4,500		
		Bal c/f	28,550
Total	**30,650**	**Total**	**30,650**

Bank reconciliation for Gulu Sacco for the month of December 2005

	Shs	Shs
Bal as per adjusted cash book		28,550
Add: un presented cheques		
Cheque No 20	1,200	
Cheque No 45	2,500	
Cheque No 50	1,500	
Cheque No 62	300	
Cheque No 71	2,200	
Cheque No 72	100	
Cheque No 73	800	8,600
		37,150
Less: un credited cheques		
Cheque No 101	2,400	
Cheque No 83	100	
Cheque No 550	3,200	
Cheque No 320	400	
Cheque No 900	6,000	
Cheque No 260	5,500	
Cheque No 850	1,300	18,900
Bal as per bank statement		18,250

Note:

Unpresented cheques with numbers 20,45 and 50 were unpesented in December 2002 and were still unpresented by 31 January 2003. Likewise, uncredited cheques 101 and 83 from December 2002 were still uncredited by 31 January 2003.

Where unpresented or uncredited cheques are very many, only the total can be quoted in the bank reconciliation statement. A schedule or lists of those cheques are then attached to the reconciliation statement as appendices or annexes.

Method 2:

Bank statement balance adjusted towards the cash book balance

	Shs	Shs	Shs
Bal as per bank statement			18,250
Add: Direct debits			
Ledger fee	50		
Commission	150	200	
Dishonoured cheque No. 440		1,900	
Un credited cheques:			
Cheque No 101	2,400		
Cheque No 83	100		
Cheque No 550	3,200		
Cheque No 320	400		
Cheque No 900	6,000		
Cheque No 260	5,500		
Cheque No 850	1,300	18,900	21,000
			39,250
Less: Direct credits			
CM	1,000		
CM	500		
Interest	100	1,600	
Cash book mistakes			
Cheque No 610	3,600		
Cheque No 69	4,500	8,100	
Unpresented cheques:			
Cheque No 20	1,200		
Cheque No 45	2,500		
Cheque No 50	1,500		
Cheque No 62	300		
Cheque No 71	2,200		
Cheque No 72	100		
Cheque No 73	800	8,600	
Dishonoured cheque			
Cheque No 65		2,600	20,900
Bal as per cash book			18,350

CHAPTER EIGHT

This is one of the complicated areas for MFIs, being that participants have low accounting education. None the less, we believe that the following concepts and explanations will help the trainees understand preparation of Cash Flow Statements.

8.0 Cash Flow Statements

A Cash Flow Statement is a logical statement i.e. a summary of how cash flowed in and out of the business (MFI) during the reporting period

8.1 Objective of Cash Flow Statements:

Information about the cash flow of an enterprise is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilize those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an enterprise to generate cash and cash equivalents and the timing and certainty of their generation.

The objective of this standard is to require the provision of information about the historical changes in cash and cash equivalents of a cash flow statement, which classifies cash flow during operating, investing and financing activities.

8.2 Importance of Cash Flow Information.

A cash flow statement, when used in conjunction with the rest of the financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency) and its ability to affect the amount and timing of cash flows in order to adopt changing circumstances and opportunities.

Cash flow information is useful in the ability of the enterprise (MFI) to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different enterprise.

It also enhances the comparability of the reporting of operating performance by different enterprises because it eliminates the effects of using different accounting treatment for the same transactions and events.

Historical cash flow information is often used as an indicator of the amount, timing and certainty of future cash flows. It is also useful in checking the accuracy of past assessment of future relationship between profitability and net cash flow and the impact of changing prices.

8.3 Definitions:

The following terms are used in this standard with the meanings specified;
Cash comprises cash on hand and demand deposits.

Cash Equivalents are short – term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash flows are inflows and outflows of cash and cash equivalents.

8.4 Major components of Cash Flow statements

- Cash Flows from operating activities
- Cash Flows from investing activities
- Cash Flows from financing activities
- Net increase or decrease in cash and cash equivalents
- Cash and cash equivalents at beginning of the period
- Cash and cash equivalents at end of the period

Operating activities are the principle revenue – producing activities of the enterprise and other activities.

Examples of each cash flow from operating activities are;

a) Cash receipt from the sale of goods and the rendering of services.
b) Cash receipts from royalties, fees, commissions and other revenue.
c) Cash payments to suppliers for goods and services.
d) Cash payments to and on behalf of employees.
e) Cash receipts and cash payments of an insurance enterprise for premiums and claims, annuities and other policy benefits.
f) Cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities and
g) Cash receipts and payments from contracts held for dealing or trading purposes.

Investing activities are the acquisitions and disposal of long – term assets and other investments not included in cash equivalents.

Examples of cash flows arising from investing activities are;
a) Cash payments to acquire property, plant and equipment, intangibles and other long term assets. These payments include those relating capitalised development costs and self – constructed property, plant and equipment.
b) Cash receipts from sales of property, plant and equipment, intangibles and other long term assets.
c) Cash payments to acquire equity or debt instruments of other enterprises and interests in joint venture (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purpose.
d) Cash receipts from sales of equity or debt instruments of other enterprises and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes).
e) Cash advances and loans made to other parties (other than advances and loans made by a financial institution).
f) Cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution).
g) Cash payments for futures contracts, forward contracts, option contracts are held for dealing or trading purposes or the payments are classified as financing activities; and
h) Cash receipts from futures contracts forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities. When a contract is accounted for as a hedge of an identifiable position, the cash flows of the contracts are classified in the same manner as the cash flows of the position being hedged.

Financing activities are activities that result in changes in the size and composition of the equity capital and borrowings of the enterprise.

Examples of cash flows arising from financing activities are;
a) Cash proceeds from issuing shares or other equity instruments.
b) Cash payments to owners to acquire or redeem the enterprises' shares.

c) Cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short or long term borrowings.
d) Cash repayments of amounts borrowed and
e) Cash payments by a lesser for the reduction of the outstanding liability relating to a finance lease.

Cash and cash Equivalents:

Cash equivalents are held for the purpose of meeting short – term cash commitments rather than for investment or other purposes. For an investment to qualify as cash equivalent, it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value.
Therefore an investment normally qualifies as a cash equivalent only when it has a short maturity of say, three months or less from the date of requisition.

Equity investments are excluded from cash equivalents unless they are in substance, cash equivalents, for example in the case of preferred shares acquired within a short period of their maturity and with a specified redemption date.

Bank borrowings are generally considered to be financing activities. However in some countries, bank overdrafts that are repayable on demand from an integral part of an enterprises cash management, in these circumstances, are included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to over drawn.

Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an enterprise rather than part of its operating, investing and financing activities.
Cash management includes the investments of excess cash in cash equivalents.

8.5 Presentation of Cash flow statement;

The cash flow statement should report cash flows during the period classified by operating, investment and financing activities.

An enterprise presents its cash flows from operating, investing and financing activities in a manner, which is most appropriate to its business. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the enterprise and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.

A single transaction may include cash flows that are classified differently. For example, when the cash repayment of a loan includes both interest and capital, the interest element may be classified as an operating activity and the capital elements is classified as a financing activity.

8.6 Illustrations

In order to understand the concepts of a cash flow statement, it is necessary to introduce the cash flow of a trading company before that of a Micro Finance Institution. Accountants for MFI who in most cases have little or no accounting knowledge need to understand accounting concepts right from the very basics using trading company examples and later MFI example

Exercise on preparation of Cash Flow Statements for trading companies:

Using information provided, prepare a Cash Flow statement for Underwriters Limited

The following are the abridged annual financial statements of underwriters limited

Income statement for the year ended 31 December 2003

	Shs
Revenue	850,000
Cost of sales	637,500
Gross profit	212,500
Administration expenses	(28,100)
Operating expenses	(73,600)
	110,800
Finance cost	(15,800)
	95,000
Income tax	44,000
Net profit for the period	**51,000**

Statement of changes in equity for the year ended 31st December 2003.

	Share capital Shs	Revaluation reserve Shs	Accumulated profit Shs	Total Shs
Opening	120,000	-	121,000	241,000
Revaluation of buildings	-	20,000	-	20,000
Net profit for the period	-	-	51,000	51,000
Dividends paid			(25,000)	(25,000)
Repayment of share capital	(20,000)	-	-	(20,000)
Closing	**100,000**	**20,000**	**147,000**	**267,000**

Balance sheet as at 31st December 2003

	Note	2003	2002
		Shs	Shs
Assets			
Property, plant and equipment	1	355,000	304,000
Current assets			
Inventories		82,000	42,000
Debtors and prepayments	2	84,000	59,000
Bank		-	6,000
		166,000	107,000
Current liabilities			
Creditors		72,000	35,000
Bank		43,000	-
Taxation payable		40,000	10,000
		155,000	45,000
Net current assets		11,000	62,000
Net total assets		366,000	366,000
Equity and debt			
Loan		99,000	125,000
Share Capital		100,000	120,000
Revaluation reserve		20,000	-
Accumulated profits		147,000	121,000
		366,000	366,000

Notes:

1. Property plant and equipment

	2003	**2002**
	Shs	**Shs**
Land and buildings	250,000	220,000
Machinery	35,000	20,000
Motor vehicles	6,000	4,000
Furniture	64,000	60,000
	355,000	304,000

2. Debtors and prepayment s

	2003	**2002**
	Shs	**Shs**
Debtors	63,000	43,000
Prepaid expenses	21,000	16,000
	84,000	59,000

3. The following depreciation charges are included in operating expenses
   - Machinery Shs. 25,000
   - Motor vehicles Shs 2,000

4. A fully depreciated machinery with an original cast of Shs 15,000 was sold for Shs 5,000 during the year.

   Profit is included in the operating expenses.

Required:

Prepare a cash flow statement in accordance IAS 7.

Underwriters Limited
Cash Flow Statement
For the year ended 31 December 2003

	Shs	Shs
Profit before interest and tax		10,800
Adjustments for:		
Depreciation		27,000
Elimination of profit on sale of machinery		(5,000)
		132,800
Changes in working capital changes:		
Increase in debtors	(20,000)	
Increase in prepayments	(5,000)	
Increase in inventory	(40,000)	
Increase in creditors	37,000	
Cash Flows from operating activities		(28,000)
Taxation	(14,000)	
Dividends	(25,000)	
Interest paid	(15,800)	(54,800)
Net Cash flows from operating activities		**50,000**
Cash Flows from investing activities		
Purchase of Land and Buildings	(10,000)	
Sale of Motor Vehicle	5,000	
Purchase of Motor Vehicle	(4,000)	
Purchase of Furniture & Fittings	(4,000)	
Purchase of Machinery	(40,000)	
Net operating cash flows from investing activities		**(53,000)**
Cash flows from financing activities		
Share redemption	(20,000)	
Loan repayment	(26,000)	
Net operating cash flows from financing activities		**(46,000)**
Net decrease in cash and cash equivalents		**(49,000)**
Cash and cash equivalents b/f		6,000
Cash and cash equivalents c/f		**(43,000)**

Exercise on preparation of Cash Flow Statements for MFIs:

Using the financial statements of Isingiro Sacco, prepare the sacco's Cash Flow Statement.

Isingiro sacco
Balance sheet as at 31 December 2004

		2004	2003
		Shs 000	**Shs 000**
ASSETS	**Note**		
Loans and Advances	1	24,690,097	25,646,500
Short term investments	2	538,082,450	266,750,500
Cash and bank balances	3	45,388,750	118,465,000
Receivables (Debtors)	4	45,249,691	15,162,500
Property & Equipment	5	18,525,556	19,534,485
Other assets		-	9,404,518
TOTAL ASSETS		**671,936,544**	**445,081,303**
LIABILTIES			
Savings and time deposits	6	596,869,169	389,381,000
Accounts payable and accruals	7	32,504,051	28,726,500
Taxation payable		-	-
Total liabilities		**629,373,220**	**418,107,500**
EQUITY AND RESERVES			
Members' shares (Capital)		14,849,750	13,020,000
Statutory & Legal reserves		2,903,305	2,903,500
Donations (Deferred income)	8	18,450,590	5,782,500
Retained earnings December 2005	9	6,359,679	5,267,803
Total equity and reserves		**42,563,324**	**26,973,803**
TOTAL RESERVES AND LIABILITIES		**671,936,544**	**445,081,303**

Isingiro Sacco Income Statement for the Period Ended 31 December 2004

	Note	2004 Shs 000	2003 Shs 000
INCOME			
Interest income	10	52,350,428	20,578,000
Interest expense		-22,170,215	-14,348,500
Net interest income		30,180,213	6,229,500
Loan loss provision		-1,278,029	-
Net interest income after provision for loan loss		**28,902,184**	**6,229,500**
Loan commission income		4,924,370	1,387,500
Other income		13,101,324	7,067,000
Total income		**46,927,878**	**14,684,000**
EXPENDITURE			
Administration expenses	11	19,464,077	16,888,995
Operating expenses	12	29,098,476	10,368,000
Total expenditure		**48,562,553**	**27,256,995**
Loss for the period		-1,634,675	-12,572,995
Grant income		2,726,550	12,362,020
Taxation		**-**	-
Net Profit for the period		**1,091,875**	**-210,975**
Transfer to reserves		**1,091,875**	**-210,975**

Isingiro SACCO

Cash Flow Statement for the Period Ended 31 December 2004

	2004 **Ushs 000**
OPERATING ACTIVITIES	
Operating surplus for the period	1,091,875
Adjustments for:	
Depreciation	2,321,629
Impairment of stock & other assets	-
Deferred income	- 2,726,550
Loan loss provision	1,278,029
Operating surplus before working capital changes	**1,964,984**
Increase in Receivables	- 30,087,191
Increase in Savings and time deposits	207,488,169
Increase in Accounts payable and accruals	3,777,551
Increase in Loans and advances	- 321,626
Taxation payable	-
Cash generated from operations	**182,821,887**
INVESTING ACTIVITIES	
Increase in investments	- 271,331,950
Purchase of property and equipment	-
Disposal of other assets	9,404,518
Net cash outflow from investing activities	**- 263,240,132**
FINANCING ACTIVITIES	
Members shares	1,829,750
Donations (Deferred income)	15,394,640
Net cash inflow from financing activities	**17,224,390**
Net increase in cash and cash equivalents	- 73,076,250
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	118,465,000
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	**45,388,750**

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