FINANCIAL ACCOUNTING BOOK

ACCOUNTING PROFESSION OPTION

for Rwandan Schools

Senior 5 Student Book

EXPERIMENTAL VERSION

Kigali, 2023

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FOREWORD

Dear Student,

Rwanda Basic Education Board (REB) is honoured to present Senior 5 Financial Accounting book for the students of Accounting Profession Option which serves as a guide to competence-based teaching and learning to ensure consistency and coherence in the learning of the Financial Accounting. The Rwandan educational philosophy is to ensure that you achieve full potential at every level of education which will prepare you to be well integrated in society and exploit employment opportunities.

The government of Rwanda emphasizes the importance of teaching and learning materials in accordance with the syllabus to facilitate your learning process. Many factors influence what you learn, how well you learn and the competences you acquire. Those factors include the relevance of the specific content, the quality of teachers' pedagogical approaches, the assessment strategies and the instructional materials available. In this book, we paid special attention to the activities that facilitate the learning process in which you can develop your ideas and make new discoveries during concrete activities carried out individually or in groups.

In competence-based curriculum, learning is considered as a process of active building and developing knowledge and meanings by the learner where concepts are mainly introduced by an activity, situation or scenario that helps the learner to construct knowledge, develop skills and acquire positive attitudes and values.

For efficiency use of this textbook, your role is to:

- Work on given activities which will lead you to the development of skills ;
- Share relevant information with other learners through presentations, discussions, group work and other active learning techniques such as role play, case studies, investigation and research in the library, and through internet,
- Participate and take responsibility for your own learning ;
- Draw conclusions based on the findings from the learning activities.

To facilitate you in doing activities, the content of this book is self-explanatory so that you can easily use it yourself, acquire and assess your competences. The book is made of units as presented in the syllabus. Each unit has the following structure : the unit title and key unit competence are given and they are followed

by the introductory activity before the development of Financial Accounting and concepts that are connected to real world problems more especially to production, finance and economics.

The development of each concept has the following points:

- Learning activity which is a well set and simple activity to be done by students in order to generate the concept to be learnt;
- Main elements of the content to be emphasized;
- Worked examples; and
- Application activities to be done by the user to consolidate competences and assess the achievement of objectives.

Even though the book has some worked examples, you will succeed on the application activities depending on your ways of reading, questioning, thinking and handling calculation problems not by searching for similar-looking worked out examples.

Furthermore, to succeed in Financial Accounting, you are asked to keep trying ; and sometimes you will find concepts that need to be worked on them before you completely understand. The only way to really grasp such a concept is to think about it and work related problems found in other reference books.

I wish to sincerely express my appreciation to the people who contributed towards the development of this book, particularly, REB staff, development partners, Universities Lecturers and Secondary School Teachers for their technical support. A word of gratitude goes to Secondary Schools Head Teachers, Administration of different Universities (Public and Private Universities) and development partners who availed their staff for various activities.

Any comment or contribution for the improvement of this textbook for the next edition is welcome.

Dr. MBARUSHIMANA Nelson

Director General, REB

ACKNOWLEDGEMENTS

I wish to express my appreciation to the people who played a major role in the development of this financial Accounting book for Senior 5 students in Accounting Profession Option. It would not have been successful without active participation of different education stakeholders.

I owe gratitude to different universities and schools in Rwanda that allowed their staff to work with REB in the in-house textbooks production initiative.

I wish to extend my sincere gratitude to Universities Lecturers, Secondary school teachers and staff from different education partners whose efforts during writing exercise of this book were very much valuable.

Finally, my word of gratitude goes to the Rwanda Basic Education Board staffs who were involved in the whole process of in-house textbook Elaboration.

Joan MURUNGI

Head of CTLR Department

TABLE OF CONTENT

FOREWORD iii

ACKNOWLEDGEMENTS v

ACCRONYMS AND ABBREVIATIONS viii

UNIT 1: YEAR - END ADJUSTMENTS 1

1.1.Closing stock 2

1.2. Bad and doubtful debts 8

1.3. Prepayments and accruals 15

1.4. Depreciation for non-current assets 19

1.5. Disposal of non-current asset 26

1.6.Provision for discount allowed 30

1.7. Adjusted trial balance 34

End unit assessment 1 36

UNIT 2: FINANCIAL STATEMENTS FOR A SOLE TRADER AFTER ADJUSTMENTS 37

2.1. Income statement/ Statement of Profit or Loss after adjustments 37

2.2. Balance sheet (statement of Financial position) after adjustments 62

2.3. Cash-Flow Statement (Statement of Cash-Flow) 70

End unit assessment 2 81

UNIT 3: PARTNERSHIP ACCOUNTS 82

3.1. Introduction to partnership 83

3.2. Introduction to partnership accounts 88

3.3. Components of Partnership Final accounts 90

End unit assessment 3 111

UNIT 4: INTRODUCTION TO NON-PROFIT ORGANIZATIONS 116

4.1. Introduction to non-profit organizations 117

4.2. Accounting for non-profit making organization.. 126

End unit assessment 4.. 127

UNIT 5: PUBLIC SECTOR ACCOUNTING 129

5.1. Public Finance management (PFM) legal framework.............................. 129

5.2. Record Government Revenues and Expenditures 140

5.3. Preparation of financial statements for public institutions.................... 162

5.4. Government budget in accordance with the requirements of IPSAS24..... 177

End unit assessment 5.. 193

UNIT 6: INTRODUCTION TO COMPANY ACCOUNTS.................................... 194

6.1. Introduction to limited liability Company.. 195

6.2. Accounting and adjustments of shares.. 203

End unit assessment 6.. 216

REFERENCE 217

ACCRONYMS AND ABBREVIATIONS

FIFO: First in, first out method

LIFO: Last in, first out

RWF: Rwandan Franc

C.G.S: Cost of Goods Sold

A/C: Account

P&L: Profit and Loss

Dr: Debit

Cr: Credit

FC: Fixed Cost

SV: Salvation Value

V.A.T.: Value-Added Tax

W/O: Goodwill

NBV: Net Book Value

LLP: Limited Liability Partnership

IFRS: International Financial Reporting Standards

GAAP: General Accepted Acounting Princilples

LLC: Limited Liability Company

NPOs: Nonprofit Organizations

NGOs: Non-Government Organizations

PFM: Public Finance management

IPSASB: International Public Sector Accounting Standards Board

RITCO: Rwanda Interlink Transport Company

WASAC: Water and Sanitation Corporation

BNR: National Bank of Rwanda

MTEF: Medium Term Expenditure Framework

IPSAS: International Public Sector Accounting Standards

SCoA: Standard Chart of Accounts

EDPRS: Economic Development and Poverty Reduction Strategy of Rwanda

GFS: Government Finance Statistics

U.K: United Kingdom

U.S.A: United States of America

IFMIS: Integrated Financial Management Information System

IPPIS: Integrated Personnel and Payroll Information System

RRA: Rwanda Revenue Authority

E-tax: Electronic Tax

E-procurement: Ectronic Procurement

GFAAG: The general Fixed Assets Account Group

GLTDAG: The General Long-Term Debt Account Group

GLTD: General Long Term Debt Payable

N.S.S.F: National Social Security Fund

RSSB: Rwanda Social Security Board

Unit 1 YEAR - END ADJUSTMENTS

Key unit competence: To be able to carry out adjustments and prepare an adjusted trial balance

Introductory activity

Regardless of the type of the business or the accounting system used, it is not possible to keep all accounts up to date at all times. At the end of each financial year, some accounts must be updated by adjusting entries. Adjustments or provisions are normally made for bad and doubtful debts, depreciation, prepaid expenses and income, accrued expenses and income, provisions are also made for corporation taxes payable and for appropriations such as payment of dividends or proposed dividends, transfers to reserves etc.

After adjusted recorded entries and affected accounts in the adjusted trial balance, the accounts will reflect the current status of the organization and financial statements can then be prepared.

1. Why do businesses make adjustments?
2. List at least four types of transactions that may be the cause of the adjustment
3. How does an adjusted trial balance differ from an unadjusted trial balance?

1.1.Closing stock

Learning Activity 1.1

During a given period of time, the business purchases items for reselling them to different customers. By the end of this time some unsold items are remaining in the store.

a) What is the accounting terminology for goods not yet sold at reporting date?

b) What is their use in determining the cost of goods sold?

1.1.1.Meaning of the closing stock

Closing stock is the amount of inventory that a business still has on hand at the end of a reporting period. This includes raw materials, work-in-process, and finished goods inventory. Certain items charged to expense as incurred, such as production supplies, are not considered to be part of closing stock. The amount of closing stock can be ascertained with a physical count of the inventory. It can also be determined by using a perpetual inventory system and cycle counting to continually adjust inventory records to arrive at ending balances**.**

The amount of closing stock (properly valued) is used to arrive at the cost of goods sold in a periodic inventory system with the following calculation:

Opening stock + Purchases - Closing stock = **Cost of goods sold**

The opening stock for the next reporting period is the same as the closing stock from the immediately preceding period.

There are a variety of methods available for calculating the recorded value of closing stock, including the methods noted below:

- **First in, first out method (FIFO)**

Under the first in, first out method, the costs of all separately-purchased goods are stored in cost layers. When a unit is sold, the cost of the oldest item in inventory is assigned to it. Assuming inflation is present, this tends to result in a lower cost of goods sold, and therefore more reported profits.

- **Last in, first out (LIFO)**

Under the last in, first out method, the costs of all separately-purchased goods are stored in cost layers. When a unit is sold, the cost of the newest item in inventory is assigned to it. Assuming inflation is present, this tends to result in

a higher cost of goods sold, and therefore lower reported profits.

- **Weighted average method**

Under the weighted average method, the costs of all separately-purchased goods are combined to create a weighted-average cost. Since it results in an average cost, it tends to result in reasonable cost of goods sold and profit figures, irrespective of the inflation rate.

1.1.2. Determine the use of closing stock

Inventory system

For merchandising firms, an initial step in assessing profitability is gross profit (also called profit margin or gross margin), which is the difference between sales revenues and cost of the goods sold. When they sell the goods, the cost of the inventory becomes an expense, cost of goods sold or cost of sales, in the income statement. We deduct this expense from net sales to determine gross profit, and we deduct additional expenses from gross profit to determine net income.

Methods of recording stock (Inventory system)

There are 2 main methods of recording stock. These are: **periodic method** and **perpetual method**.

a) Perpetual inventory system

Perpetual inventory system or method is the method that consists to keep a continuous record of inventories and cost of goods sold. This daily record helps managers to control inventory levels and prepare interim financial statements. **Perpetual inventory:** It is a system of stock maintenance consisting in continuous taking of stock flows so to provide at any time the stock in trade and cost of sales.

In the perpetual inventory system, the journal entries are:

- When inventory is purchased:

Merchandise inventory…………..xxx

Accounts payable (creditors) or cash …………xxx

- When inventory is sold:

Accounts receivable (debtors) or cash…yyy

Sales revenue…………………………………………..yyy

Cost of goods sold…………………………..xxx
Inventory……………………………………………xxx

EX: On 6th May, Sosso purchases some merchandises for RWF 500 000 from Tindo, and agrees to pay for them within the next two weeks. On 10th May, goods which had cost RWF100 000 were sold on credit to Pupette for RWF 200 000. Show journal entries to record the above transaction.

Date	Particulars	Debit (RWF)	Credit(RWF)
6th May	Merchandise inventory a/c	500,000	
	To Tindo a/c		500,000
	(Being purchases of goods)		
10th May	Pupette a/c	200,000	
	To sales revenue a/c		200,000
	Cost of goods sold a/c	100,000	
	To Merchandise inventory		100,000
	(Being sales of goods on credit)		

a) Periodic inventory system

Periodic inventory system or method does not involve a day-to-day record of inventories or of the cost of goods sold. Instead, we compute the cost of goods sold and an updated inventory balance only at the end of an accounting period.

Physical count:

It is the process of examining and identifying all items in inventory. The physical count allows management to remove damaged or obsolete goods from inventory and thus helps reveal inventory shrinkage, which refers to losses of inventory from theft, breakage and loss. Under the periodic inventory method, we delay computing cost of goods sold until we make a physical count:

Beginning Inventory + Purchasing – Ending Inventory = Cost goods sold Goods available for sale – Inventory left over = Cost of Goods Sold

Beginning inventory: Are the goods (products) which are remained at the end of last period

These are goods that we have in our store when we begin the period.

Example ones:

Opening stock: RWF 12,000,000

Periodical Purchasing: RWF 20,000,000

Closing stock: RWF 10,000,000

Calculate: inventory available for sale and cost of goods sold

Solution:

Inventory available for sale = Opening inventory + Purchasing = RWF 12,000,000 + RWF 20,000 000 = RWF 32,000,000

Cost of goods sold: Opening inventory + purchasing – closing inventory

= RWF 12,000,000 + RWF 20,000,000 – RWF 10,000,000 = RWF 22,000,000

Or: Goods available for sale – Closing inventory = RWF 32,000,000 – RWF 10,000,000 = RWF 22,000,000.

Example two:

Compute the following:

Closing stock: Cost of goods available for sale – Cost of goods sold

Cost of goods available for sale: Opening stock + net purchases

Net purchase: (purchases-purchases returns) + carriage inwards
Purchases..................... 200,000

Opening stock................100,000

Cost of goods sold............180,000

Purchases return...............50,000
Carriage inwards.............. 20,000

Solution:

Opening stock...100,000
Purchases..200,000

Less: Purchases return.......................... (50,000)

150,000

Add: Carriage inwards.............................20,000

Net purchases... 170,000

Cost of goods available for sale............................ 270,000

Less: Cost of goods sold...................................(180,000)

Closing stock...90,000

Example three:

Cost of goods sold (C.G.S):

Cost of goods available for sale – Closing stock

Purchases.....................340,000

Opening stock................150,000

Closing stock..................80,000

Purchases return..............70,000

Carriage inwards............. 30,000

What is the cost of goods sols?

Solution:

Opening stock..150,000
Purchases......................................340,000

Less: Purchases return................. (70,000)

270,000

Add: Carriage inwards.................30,000

Net purchases.. 300,000

Cost of goods available for sale............................. 450,000

Less: Closing stock.. (80,000)

Cost of goods sold..370,000

Illustration

- July 1: Goods purchased from Haraka RWF 500,000 (1,000 units at RWF 500 each).
- July 4: 100 units of goods costing RWF 50,000 are returned to the supplier being defective.
- July 6: Sold 400 units for cash at RWF700 each.
- July 14: Sold 200 units at RWF 800 each to Jambo on credit.
- July 18: Jambo returned 10 units being poor in quality.

Required: Prepare journal entries of the above transactions using periodic and perpetual inventory

Answer:

Periodic inventory

Dates	Particulars	Debit	Credit
1/7	Purchases a/c To creditor Haraka a/c	500,000	 500,000
4/7	Creditor Haraka a/c To Purchases returns	50,000	 50,000
6/7	Cash a/c To Sales a/c	280,000	 280,000
14/7	Debtor Jambo a/c To Sales a/c	160,000	 160,000
18/7	Sales returns a/c To Debtor Jambo a/c	8,000	 8,000

Perpetual inventory

Dates	Particulars	Debit	Credit
1/7	Stock in trade To Creditor Haraka a/c	500,000	 500,000
4/7	Creditor Haraka a/c To Stock in trade a/c	50,000	 50,000
6/7	Cost of sales a/c To stock in trade a/c	200,000	 200,000
	Cash a/c To sales a/c	280,000	 280,000
14/7	Cost of sales a/c To stock in trade a/c	100,000	 100,000
	Debtor Jambo a/c To sales a/c	160,000	 160,000

18/7	Stock in trade a/c To cost of sales a/c	5,000	 5,000
	Sales returns a/c To cost of sales a/c	8,000	 8,000

In trading account, when the perpetual inventory is used, the cost of sales is available without using the formula: Cost of Goods Sold = Opening Stock + Net Purchases-Closing Stock. One of the advantages of the perpetual inventory is a simple detection of thefts and losses in stock.

Application activity 1.1

1. Define the closing stock
2. How is it used in determining the cost of goods sold?
3. What are the different methods applied for calculating the recorded value of the closing stock?
4. Answer by yes or no:
   - The opening stock for the next reporting period is the same as the closing stock from the immediately preceding period.
   - The closing stock for the next reporting period is the same as the opening stock from the immediately preceding period.
   - The opening stock from the immediately preceding period is the same as the closing stock for the next reporting period
   - The opening stock for the next reporting period is the same as the opening stock from the immediately preceding period.

1.2. Bad and doubtful debts

Learning Activity 1.2

In large businesses, most of transactions are made on credit basis. Due to various reasons, the outstanding amounts in debtor accounts are likely not to be collected fully or partly and then, the book keeper has a task of providing for this unknown liability:

a) State any two reasons why a debt may be irrecoverable?

b) What can you do if someone who owes you money informed you that he/she will not pay due to insolvency?

Introduction on bad debts

Bad debt refers to the **sum due from the debtors**, which remains unrealized, and so they are written off in the company's books of accounts. As against, doubtful debts refer to the debt, with which there is an uncertainty, as to the degree to which amount will be recovered from the debtor.

Bad debts are incurred when it is reasonably certain that a debtor to a business will not be paying. For example, the debtor's business may itself have collapsed- leaving no funds in which to pay its obligations.

You should treat bad debts in the same manner as any other expense. In other words, we pass a journal entry where bad debts are debited, and debtor's account is credited.

Doubtful debts, in addition to bad debts, you may also be required to account for doubtful debts. In practice, businesses have learnt from experience that some debtors will not pay, but they are not certain which debtors this applies to at the end of the year.

Provision for doubtful & bad debts

The provision for doubtful debts is an estimated amount of bad debts that are likely to arise from the accounts receivable that have been given but not yet collected from the debtors. This is subtracted from the trade receivables figure on the balance sheet so as to give a more realistic figure for the amounts likely to be collected. It is similar to the allowance for doubtful accounts.

Provision is an amount set aside for a probable loss of receivables which cannot be calculated with absolute accuracy. When a debtor becomes bad / doubtful, a provision for bad debt is to be created.

Reasons for bad and doubtful debt

1. Failure to pay despite persistent reminders
2. Death of a debtor
3. Bankruptcy of a debtor
4. Default by debtor
5. Etc

Creating provision for bad and doubtful debts

Provision for bad debts should be created for all those accounts that have a high possibility of not being collected. For example, a company has debtors totaling

RWF 5,000,000 but 10% of them are doubtful and are likely not to pay. If it is the 1st year of trading (1st year of making provision), a provision for bad and doubtful debts should be created by making the following entry:

Dr: Bad and doubtful debts expense A/C 500,000

Cr: Provision for bad and doubtful debts A/C 500,000

Bad and doubtful debts account above is sometimes simply referred to as bad debts expense account.

A provision for doubtful debts can either be for a specific or general provision. A specific provision is where a debtor is known and chances of recovering the debt are low. The general provision is where a provision is made on the balance of the total debtors i.e. debtors less bad debts and specific provision.

Particulars	RWF
Debtors	X
Bad debts	(X)
Balance sheet amount	X
Specific provision	(X)
	X
General provision	(X)
Realized amount	X

Writing off a bad debt

In some cases, the debtors who were once doubtful truly become bad and their amounts are irrecoverable. Their accounts have to be written off. The accounting entry to write off a debt for which a provision had been created, using the above example:

Dr Provision for bad and doubtful debts A/C RWF 500,000

CR Debtor's A/C RWF 500,000

Direct write off of a bad debt

For small debtor's amounts or receivables, there is no need to create a provision for bad debts, a direct write off can be made to the profit and loss A/C. For example, Jane deals in sale of stationery items, she sold a pen to John for RWF 10,000 on credit but John has defaulted and is not likely to pay.

The accounting entry to write off the small amount is as follows:

Dr Profit and Loss (P&L) A/C (bad debts) 10,000

Cr Debtor's A/C (John's A/C) 10,000

Increasing the provision for bad debts

At times the provision for bad debts might have to be increased beyond the current provision i.e. in the subsequent periods. For example, if the current provision for bad debts is RWF 2,000,000 but has to be increased to RWF 3,000,000.

The accounting entry is as follows:

Dr Bad debts expenses A/C 1,000,000

Cr Provision for bad debts A/C 1,000,0000

The accounting entry is performed with the difference ie. RWF 3,000,000 – RWF 2,000,000 = RWF 1,000,000

Decreasing the provision for bad debts

If debtors start pa and there is little doubt about the amounts being collected, a provision for bad debts which was once high can be reduced. For example, a provision of RWF 5,000,000 had been made against bad debts; the provision is now to be reduced to RWF 3,000,000.

Accounting entry is as follows:

Dr provision for bad debts A/C 2,000,000

Cr Profit and Loss A/C (Reduction in bad debts provision) 2,000,000

Collecting a bad debt that had been written off

An account that had been written off as irrecoverable, or bad can be collected at a future date may be after 2 or more years. For instance, Mary sold goods to Joseph for RWF 10,000,000 on credit. Joseph failed to pay and disappeared for long time and was subsequently written off by Mary as a bad debtor. Surprisingly after 5 years, Joseph surfaced and paid Mary by cheque in full settlement of his debt.

The accounting entries to record the above are as follows:

The first step is to reinstate Joseph as a debtor and the following entry is made:

Dr Debtor's (Joseph's A/C) 10,000,000

Cr Bad debts recovered A/C 10,000,000

The second step is to record the receipt of a cheque using the following entry:

Dr Bank A/C 10,000,000

Cr Debtors A/C (Joseph's A/C) 10,000,000

The third step is to close the bad debts recovered A/C to the profit and loss A/C by using the following entry:

Dr Bad debts recovered A/C 10,000,000

Cr Profit and Loss A/C 10,000,000

The following journal entries illustrate the points discussed above:

Date	Particulars	Debit	Credit
A	To write off bad debt: Bad debts account To Debtor's personal a/c (Writing off bad debtors)	 Xxxx	 xxxx
	Profit and loss account To bad debts account (closing the profit and loss account)	Xxxx	 xxxx
B	To create a provision for bad debts Profit and loss account To provision for bad and Doubtful debts	 xxxx	 xxxx
	(creating the provision for bad and doubtful debts)		
C	To increase the provision Profit and loss account To provision for bad and Doubtful debts (increasing the provision)	 xxxx	 xxxx

D	To reduce a provision for bad debts Provision for bad and doubtful debts To profit and loss a/c (reducing the provision for bad debts)	xxxx	xxxx

Example

The following information related to trade debtors in the books of Joel, a retailer, at 31st March 2004.

Particulars	Amount (RWF)
Trade debtors	140,900
Bad debts written off	700
Provision for bad debts b/f 1/4/2003	2,400

A further RWF 900 is to be written off as an additional bad debt while the provision for bad debts is to be adjusted to 2% on the remaining balance of debtors. The accounting book closes each year on 31st March.

Required: Record the above information in Joel's journal and ledger.

Solution:

Joel

Adjusting Entries-Journal

Details	Dr	Cr
Bad Debts Account	900	
Sundry Debtors' (Personal) Account		900
Bad debts written off:		
Bad and doubtful Debts Account	400	
Provision for bad &doubtful debts A/C		400
Profit and Loss Account	400	
Provision for bad debt Account		400
(Closed to Profit and Loss Account)		

	Dr. FRW	Cr. FRW
Sales returns	50,000	
Sales discounts	60,000	
Drawings	2,060,000	
Creditors		2,000,000
Income taxes payable		3,500,000
Purchases returns		500,000
Discounts received		80,000
Sales		12,000,000
Provision for bad debts 1/4/2017		60,000
Capital		6,860,000
Long term bank loan		2,000,000
	27,000,000	27,000,000

Application activity 1.2

1. State any two reasons why a debt may be irrecoverable
2. What does the supplier do when it is confirmed that the customer will not settle his/her account?
3. State the respect steps to adjust the provision for bad and doubtful debts
4. Distinguish bad debts from doubtful debts

1.3. Prepayments and accruals

Learning Activity 1.3

By the end of the reporting period, some expenses and income may be incurred/occurred but not yet paid or received. On the other hand, some expenses and income may be paid or received but not yet occurred or incurred.

1. State some reasons why expenses or income may be incurred / occurred by the end of the reporting period but remain unpaid or uncollected

1.3.1. Accruals

Accruals are revenues earned or expenses incurred that impact a company's net income on the income statement, although cash to the transaction has not yet changed hands. Accruals also affect the balance sheet, as they involve non-cash assets and liabilities

a) Accrued expenses/outstanding expenses

The expenses incurred in one financial year but not paid until the next financial year, are called accrued expenses.

- They are added to the expenses actually paid
- In the balance sheet they appear as current liabilities (CL)

Accounting entries

Dr Profit and Loss account or respective Expenses account

Cr Accrued expenses account

For instance, a company's financial year ends on 31st December. During a particular financial year, December salaries totaling RWF 4,000,000 could not be paid until January the following year. Record the adjusting entry at the end of the financial year for the accrued salaries.

Dr Salaries A/C 4,000,000

Cr salaries payable A/C 4,000,000

Instead of using the word salaries payable, accrued salaries could have been used.

b) Accrued income/ incomes outstanding

Income earned in one financial year but not received until the following financial year is called accrued income. It is treated as a current asset in the balance sheet.

- Incomes outstanding are added to incomes actually received for the period.
- Accrued income is a current asset in a balance sheet.

Accounting entries:

Dr Accrued income A/C

Cr Profit and Loss or respective Income received or gain A/C

For instance, Peter offered consultancy services to a client and invoiced him RWF 3,000,000 but the client could not pay in the financial year and promised to pay in the next financial year. Record the adjusting entry for the consultancy fees which accrued at the end of the financial year.

Dr consultancy fees receivable A/C (Debtor's A/C) 3,000,000

Cr Consultancy fees (revenue/income) A/C 3,000,000

Illustration

1. Monthly rent of A&B stores is RWF 4,000. Rent paid during the year amounted to RWF 40,000. Show the entries in Rent Account and Profit and Loss Account as at 31st December.

Answer:

Entries in rent account and profit and loss account:

Dr: Rent account/profit and loss account 48,000

Cr: Cash/bank account 40,000

Cr: Accrued rent account 8,000

Or:

Dr: Rent account/profit and loss account 40,000

Cr: cash/bank account 40,000

Dr: Rent/ profit and loss account 8,000

Cr: Accrued rent account 8,000

1.3.2. Prepayments

Prepayment refers to paying off an expense or debt obligation before the due date. Often, companies make advance payments for expenses as well as goods and services to shed their financial burden.

a) Prepaid expenses/ expenses paid in advance or unexpired values

These are expenses paid in advance. Adjustment must be made for expenses that are paid in one financial year but benefit the next/following financial year.

- Such expenses are deducted from the period's expenses in the profit and loss account
- Expenses in advance are current assets (CA) in the balance sheet.

Accounting entries:

Dr: prepaid expenses account

Cr Profit and Loss Account or respective Expenses account

Example 1

Rent of RWF 3,000,000 cash was paid on 1st January 1999 to cover a period to 31st March 2000 (15 months). Record the adjusting entry for the prepaid rent at the end of the financial year on 31st December 1999.

Monthly rent payment = RWF 3,000,000/15= RWF 200,000

Since the financial year is 12 months and the rent had been paid for 15 months' rent spills to the following financial year and is called prepaid rent.

Prepaid rent = 200,000 × 3 = RWF 600,000

Adjusting entry for the prepaid rent is as follows:

Dr: Prepaid Rent A/C 600,000

Cr: Rent 600,000

Prepaid rent of RWF 600,000 will appear in the balance sheet as an asset while in the income statement, the rent expense will be RWF 2,400,000

i.e: RWF 3,000,000 – RWF 600,000

Example 2

During 2004, electricity is paid RWF 25,000 every 4 months. An excess of RWF 25,000 has been made as a prepayment, and thus it is paid and therefore carried forward to the next year. Show the electricity account

Answer

Dr			Electricity account		Cr
2004 April 30	bank	25,000	2004 Dec 31	P&L	75,000
August 31	bank	25,000			
December 31	bank	50,000	Dec 31	Prepaid elec.	25,000
		100,000			100,000

b) Prepaid income/ income received in advance

Some businesses receive income before it is earned. For instance, it is a common practice in Rwanda for landlords or land ladies to ask tenants to prepay or pay rent in advance for 2 years, 3 years etc. Adjustments must be made for that income which was received but services were not offered to the customer. Unearned income is treated as a current liability in the balance sheet.

- The incomes received in advance are subtracted from the incomes for the period in income statement
- In the balance sheet, income in advance is short term liability.

Accounting entries:

Dr: Profit and Loss A/C or Income received account

Cr: Income received in advance or respective income or gain A/C

Example

A tenant was made to pay rent of RWF 1,800,000 cash for the period of 1 ½ years.

Required:

- Journalize the entries when the rent was paid
- Journalize the adjusting entry at the end of the financial year (1st 12 months)

Answer:

i. Dr Cash A/C 1,800,000

Cr Unearned rent Income A/C 1,800,000

Monthly rent payment = RWF 1,800,000/18 =RWF 100,000

Rent earned for the year =RWF 100,000 × 12 = RWF 1,200,000

The following entry is then performed to recognize the income which was unearned but has now been earned.

ii. Dr: Unearned rent income A/C 1,200,000

Cr: Earned rent income A/c 1,200,000

Application activity 1.3

1. Distinguish prepaid income from prepaid expenses
2. How do accrued expenses differ from accrued income?
3. Answer by yes or no:
   - Accrued income is a current liability
   - Accrued expense is a current asset
   - Prepaid income is a current liability
   - Prepaid expense is a current asset
   - To adjust for accrued expenses, debit the amount outstanding to the respective expenses account and credit it to the liability account.
4. Insurance of RWF 4,000,000 had been prepaid cash for 2 years. At the end of the 1st year half of the prepaid insurance had expired or got used up.

   Required: Record the adjusting entry at the end of the first financial year.

1.4. Depreciation for non-current assets

Learning Activity 1.4

Non-current assets may be characterized as assets that will generate economic value for one or more fiscal periods into the future. For example, consider a business that owns manufacturing equipment; an effective management team will use that equipment to manufacture products for as long as it is safe and practical to do so. The economic benefit materializes in the future when those products are sold to generate revenue and then, these assets decrease their original value progressively.

a) State the causes why a fixed asset decreases its value

b) How do they call this decrease in value of an asset?

1.4.1. Meaning of depreciation

Depreciation is the loss of value sustained by non-current asset over its lifetime in the business. Depreciation of fixed assets is an **accounting term that is used to represent how much of an asset's value has been used up over time**. Depreciation is therefore a calculated expense, which leads to a decrease in earnings. Depreciation is an expense to the business even if it does not necessarily involve cash outlay. It is prudent to charge depreciation annually to the profit and loss account.

1.4.2. Causes of depreciation

Depreciation on non-current assets is caused by:

a) Wear and tear
b) Passage of time
c) Obsolescence
d) Physical factors
e) Economic factors

1.4.3. Reasons for providing depreciation

Once a decision is made to depreciate an asset, the amount of depreciation written off is transferred to the profit and loss account as an operating expense for the period. Depreciation is debited to the profit and loss account for the period thus reducing current profits otherwise profit will be overstated.

Provision for depreciation is made for the following reasons:

a) It ensures that revenues recognized during a particular accounting period bear the full cost of the permanent resources used up during the same period,
b) It allocates the depreciable amount of an asset over its useful life, ensuring that each accounting period bears part of the depreciation expense,
c) It provides a meaningful base of valuation and disclosure of non-current assets in financial statements,
d) It ensures that provision is made for the loss sustained by non-current assets.
e) It ensures availability of tax benefits

1.4.4. Factors for depreciation

- **Cost of the asset:** purchase cost + transportation Cost (if any) + installation costs (if any) + other costs that should be capitalized.
- **Estimated useful/economic life of an asset**: this refers to the period during which an asset is expected to serve the business.
- **Scrap/residual value/ estimated salvage**: the estimated amount that the owner of a fixed asset expects to receive at the time of disposing off the asset.

1.4.5. Methods of charging depreciation

There are four (4) different methods of calculating the depreciation:

a) Straight line method

A fixed amount of depreciation is charged on the non-current asset, over its useful life, from the date of its acquisition. The useful life is the estimated life of the asset will remain in the business. Depreciation charge is calculated as a fixed percentage on the cost of the asset each year, until it is completely written off. This method is also known as the ***fixed instalment method***.

Annual depreciation is calculated as under:

Annual depreciation $\frac{\cos t - salvage\ value}{estimated\ number\ of\ useful\ life}$

Or, depreciable value × depreciation rate

Illustration:

A motor vehicle was purchased from Japan at Cost, Insurance and Freight (CIF) Mombasa at a value of RWF 5,000,000. It costs RWF 500,000 to transport the vehicle from Mombasa to Kigali. Total taxes paid on the purchases transaction of the vehicle amounted were to RWF 2,000,000. The vehicle is expected to be used for 5 years, the end of which it will have a scrap value of RWF 1,500,000.

Required:

a) Calculate the depreciation expense for each year and expense for each year and accumulated depreciation to year 5

b) Draw up the depreciation schedule

Solution

Total cost of the vehicle up to Kigali: RWF 5,000,000 + RWF 500,000 + RWF 2,000,000 = RWF 7,500,000

Scrap/salvage/residual value: RWF 1,500,000

Number of years of useful life: 5 years

Depreciation expenses are thus calculated:

Depreciation per year = $\frac{7.500,000-1,500,000}{5}=1,200,000$

Depreciation per annum could be expressed as a percentage of depreciable cost as follows:

=1,500,000/6,000,000*100=25%

The depreciation schedule looks like:

Year	Cost	Annual depreciation	Accumulated depreciation	Net book value
1	7, 500,000	1, 200,000	1,200,000	6,300,000
2	7, 500,000	1, 200,000	2,400,000	5,100,000
3	7, 500,000	1, 200,000	3,600,000	3,900,000
4	7,500,000	1, 200,000	4,800,000	2,700,000
5	7,500,000	1, 200,000	6,000,000	1,500,000

b) Reducing balance method (Diminishing or declining balance method)

It is also known as declining or diminishing balance method. An appropriate percentage is applied to the net value of the non-current asset brought forward to obtain the depreciation expense for the period.

Depreciation is therefore calculated as a constant proportion of the book value (cost less depreciation) of the asset after deducting the total amount of depreciation expense previously written off. As the depreciation is calculated on the reduced balance of the asset brought forward, it declines the asset over the years the asset is retained in the business, hence the name reducing balance method.

A gradual decreasing amount of depreciation charge is recorded on the asset over the years as a constant percentage is being applied to a decreasing book value of the asset.

The depreciation rate (expressed in percentage) is found as under:

Depreciation rate $=1-\sqrt[n]{Scrap\ Value/\cos t}\times 100$

Illustration:

A machine was bought at a cost of RWF 9,500,000. Installing the machine before use cost of RWF 500,000, scrap value is expected to be RWF 1,296,000 at the end of estimated life of 4 years.

Required: calculate depreciation expense and accumulated depreciation at the end of each year using normal reducing balance method.

Answer:

Depreciation rate $= 1 - \sqrt[n]{Scrap\ Value / \cos t} \times 100$

Scrap value = RWF 1,296,000

Cost = RWF 9,500,000 + RWF 500,000

= RWF 10,000,000

Depreciation rate $= 1 - \sqrt[4]{1,296,000 / 10,000,000} \times 100$

$$= 1 - \frac{6}{10}$$

$$= \frac{4}{10} or 40\%$$

Cost = RWF 10,000,000

Year	Cost	Rate	Annual depr.	Accum.dep.	Book value
1	10,000,000	40%	4,000,000	4,000,000	6,000,000
2	6,000,000	40%	2,400,000	6,400,000	3,600,000
3	3,600,000	40%	1,440,000	7,840,000	2,160,000
4	2,160,000	40%	864,000	8,704,000	296,000

c) Sum of years method or digital method

Under this method, the depreciation charge is calculated by applying a given rate on the depreciable value until it is completely written off.

Example:

Let a fixed asset having a useful life estimated at five (5) years, its annual depreciation rates are calculated as follows:

Sum of years: 1+2+3+4+5 = 15

- Rate of the period one: 5/15
- Rate of the period two: 4/15
- Rate of the period three:3/15
- Rate of the period four: 2/15
- Rate of the period five: 1/15

Illustration:

A fixed asset was bought at a cost of RWF 8,000,000, has estimated salvage value of the RWF 800,000 and estimated useful life of four years.

Calculate the depreciation expense for each year using sum of years/digits method.

Solution

Year	Cost	Rate	Annual dep.	Accum. dep	N B V
1	8,000,000	4/10	2,880,000	2,880,000	5,120,000
2	5,120,000	3/10	2,160,000	5,040,000	2,960,000
3	2,960,000	2/10	1,440,000	6,480,000	1,520,000
4	1,520,000	1/10	720,000	7,200,000	800,000

d) Unit of production method

Unit of production depreciation, also called the activity method, calculates depreciation based on the unit of production and ignores the passage of time over the useful life of an asset; in other words, a unit of production depreciation is directly proportional to production. It is mainly used in the manufacturing sector.

The value of the same asset may be different due to its usage. For example, one asset, X, produces ten units, and another asset, Y, produce 20 units. Both are the same asset, but the depreciation of Y will be higher as compared to the X asset because of more units produced.

Under this method:

$$\text{Depreciation} = \frac{unit\ produced\ during\ the\ year}{estimated\ units\ to\ be\ produced\ in\ productive\ life} \times (\cos t - salvage\ value)$$

Where the depreciation rate changes period by period depending on the annual production and then, it is calculated as under:

Annual depreciation rate = annual production/total production

And the **annual depreciation** is found as under:

Depreciable value * annual depreciation

Illustration:

1. A plant costing RWF 110 million was purchased on April 1st, 2020. The salvage value was estimated to be RWF 10 million. The expected production was 150 million units. The plant was used to produce 15 million units till the year ended December 31, 2020. Calculate the depreciation on the plant for the year ended December 31st, 2020.

Solution:

Depreciation = (15/150) × (RWF 110 million – RWF 10 million) = RWF 10 million

2. A coal mine was purchased by X Corporation for RWF 16 million. It was estimated that the mine has capacity to produce 200,000 tons of coal. The company extracted 46,000 tons during its first year of operation. Calculated the depreciation.

Solution:

Depreciation = (46,000/200,000) × RWF 16 million = RWF 3.68 million

Working hours method:

Depreciation is computed based on the number of hours the asset is expected to run in its useful life.

Depreciation expense = (number of hours worked in the year/estimated number of working hours in productive life) × (cost-salvage value).

Example

A machine costs RWF 400,000 with a salvage value of RWF 20,000. Its useful life is six years. In the first year, 4000 hours, in the second year, 6,000 hours and 8,000 hours on the third year. The expected flow of the machine is 38000 hours in six years. What is the depreciation at the end of the second year?

Solution

a) Solve for the depreciation per hour

Depreciation per hour = (FC - SV) / Total number of hours

Depreciation per hour = (400,000 - 20,000) / 38000

Depreciation per hour = 10

b) Solve for the depreciation at the end of 2nd year

Depreciation = 10 (6,000)

Depreciation = RWF 60,000

Application activity 1.4

1. Define the depreciation
2. Give some four causes for depreciation
3. What are the depreciation methods?
4. A firm bought a machine for RWF 3,200,000. It is to be depreciated at a rate of 25 per cent using the reducing balance method. What would be the remaining book value after 2 years?
   a) RWF 1,600,000
   b) RWF 2,400,000
   c) RWF 1,800,000
   d) Some other figure
5. A machine costs RWF 400,000 with a salvage value of RWF 20,000. Its useful life is six years. In the first year 4000 hours, in the second year 6000 hours and 8000 hours on the third year. The expected flow of the machine is 38000 hours in six years. What is the depreciation at the end of the second year?

1.5. Disposal of non-current asset

Learning Activity 1.5

KEZA Company Ltd, a manufacturer, holds a machine purchased 4 years ago. The machine with the useful life estimated at 10 years is depreciated annually under reducing balance method. The machine is no longer appropriate to company manufacturing and it is decided to replace the old machine by a new one which is appropriate.

1. What will the company do with the old machine?
2. What will happen in the books of account?

Introduction

The usual way of disposing of a non-current asset is by sale though an asset could be disposed by donation, trade-in, damage, etc. Whatever approach is used the non-current asset account in respect of the asset sold must be eliminated from the books to record the fact that such an asset no longer forms part of the net worth of the business. Also, the accumulated depreciation on the asset being disposed must be eliminated from the provision for depreciation account.

Disposal or sale of fixed asset is not defined as a sale in accounting and should not be credited to the sales account if the asset was bought with no intention of selling to make a profit. Credits are made to sales account for the sale of those goods that were bought with the prime intention of selling them and the domain of the business is in sale of such goods or assets.

Sale or disposal of fixed assets is not routine but incidental. It should be noted that it is only the gain on disposal of fixed assets that is credited to the profit and loss account as miscellaneous income while the loss on disposal is debited to the profit and loss account as an expense.

Gain/loss on disposal=sale/disposal amount-book value

N.B. If sale or disposal amount is greater than the book value a gain on disposal results and if the sale or disposal proceeds' are less than the book value, the nit is a loss on disposal

Accounting entries for a disposal transaction

Recording a disposal transaction requires a series of entries as follows:

1. On a fixed asset disposal account and credit that account and debit that account with the cost of fixed asset disposed off. A credit is made to the fixed asset account for fulfilment of double entry.

Dr. Disposal a/c with the cost price xxx

Cr. Fixed asset a/c with the cost price xxx

It should be emphasized that the above entries are performed using the cost of the asset disposed off.

2. Transfer the accumulated depreciation of the asset being disposed off to the disposal account. The following entry is made:

Dr. Accumulated depreciation a/c

Cr. Disposal a/c

3. Record cash received on disposal a/c i.e. disposal proceeds

Dr. Cash/bank a/c with the cash received

Cr. Disposal a/c with the cash received

4. On closing the disposal accounts to the profit and loss account, the balancing figure is either a gain or a loss on disposal.

a) Gain on disposal

Dr. Disposal a/c

Cr. Profit and loss a/c

b) Loss on disposal

Dr. Profit and loss a/c

Cr. Disposal a/c

Note: Alternatively gain or loss on disposal can be computed by deducting net book value of the disposed asset from the proceeds received upon disposal.

Illustration:

Kelly Ltd bought a motor van on 1st January 2004 at RWF 180,000 estimated to last for 5 years after which it will have a scrap value of RWF 30,000. The van was sold on 31st December 2006 for RWF 100,000.

Required:

a) Motor van a/c
b) Provision for depreciation a/c
c) Disposal of Motor van a/c

Solution: a. Motor vehicle account

Dr		Moto vehicles account	Cr
2004 Jan.1st bank	180,000	2004 dec.31st Bal c/d	180,000
	180,000		180,000
2005 Jan.1st bal.b/d	180,000	2005 dec. 31st bal c/d	180,000
	180,000		180,000
2006 Jan 1st bal b/d	180,000	2006 dec 31st disposal	180,000
	180,000		180,000

b) Provision for depreciation account

Dr **Provision for depreciation** **Cr**

2004 dec. 31st bal. c/d 30,000	2004 dec. 31st P&L a/c 30,000
30,000	30,000
2005 dec.31st bal.c/d 60,000	2005 Jan.1st Bal.b/d 30,000
	2005 dec. 31st P&L 30,000
60,000	60,000
2006 dec.31st Disposal 90,000	2006 Jan.1st bal. b/d 60,000
	2006 Jan.31st P&L 30,000
90,000	90,000

c) **Disposal account**

Dr	Provision for depreciation	Cr
2006 dec 31st Motor van 180,000	2006 dec. 31st bank 100,000	
Dec 31st P&L a/c 10,000	dec. 31st acc.dep.90,000	
190,000	190,000	

Note: There are 2 ways of considering when calculating provision for depreciation for an asset bought or sold:

1. Full year's depreciation is calculated on the assets purchased (on acquisition) irrespective of the date of purchase during any accounting period and no depreciation charged in the year of sale of the assets.

2. Depreciation is calculated on the basis of number of months that asset was in ownership of the business but fractions of the months are usually ignored.

Application activity 1.5

1. State different ways of disposing an asset.
2. Why must the asset account be closed off when the asset has been sold?
3. In disposal account, the total debit records must be compared to the total credit records. What is the meaning of the equality of total debit records and credit records in the disposal account?
4. Brighton Ltd Company bought a motor van on 1st January 2002 at RWF 180,000 estimated to last five years after which it will have a scrap value of RWF 30,000. The van was sold on 31st December 2004 for RWF 350,000

Required:

a) Motor van account

b) Provision for depreciation on motor van account

c) Disposal of motor van account

1.6.Provision for discount allowed

Learning Activity 1.6

As discussed above in 1.2, in large businesses, most of transactions are made on credit basis and the businesses, in order to stimulate their customers to buy a bulk quantity or pay promptly, they decide either to reduce monetary amount or a percentage of the normal selling price of a product or service, or to reduce the total amount payable on the invoice for an early payment discount on credit sales.

1. Why do these businesses allow this kind of discount?
2. What is the impact of this discount to the net profit?

1.6.1. Meaning of discount

A discount is the reduction of either the monetary amount or a percentage of the normal selling price of a product or service. For example, a discount of RWF 10 may be offered from the list price of a product, or as a 10% discount from the list price.

Discount results in the reduction of the selling price of the product, which makes it more attractive for the customer. Reduction in price makes a psychological impact on the customer which results in the purchase. The two types of discount offered are trade discount and cash discount.

Discounts are reductions of the regular price of a product or service in order to obtain or increase sales. These discounts also commonly referred to as "sales" or markdowns are utilized in a wide range of industries by both retailers and manufacturers.

A discount allowed is when the seller of goods or services grants a payment discount to a buyer. This discount is frequently an early payment discount on credit sales, but it can also be for other reasons, such as a discount for paying cash up front, or for buying in high volume, or for buying during a promotion period when goods or services are offered at a reduced price. It may also apply to discounted purchases of specific goods that the seller is trying to eliminate from the stock, perhaps to make way for new models.

A discount received is the reverse situation, where the buyer of goods or services is granted a discount by the seller.

The examples just noted for a discount allowed also apply to a discount received.

A discount may be given for a variety of reasons, including:

- Earlier payment than the normal credit terms offered to customers, such as a 1% discount in exchange for paying within 10 days,
- A price breaks due to the purchase of an unusually large number of units, such as a 5% discount if at least 100 units are ordered,
- A price break if a purchase is made by a specific date, such as the end of the month.
- A price break to take goods damaged in transit, or which differ from what the customer ordered.

1.6.2. Types of discount

The two types of discount offered are trade discount and cash discount :

Trade discount

Trade discount is referred to the discount that is offered by a seller to the buyer of the product in the form of reduction in the price of the item.

Trade discounts are offered to increase the sales of the product and make the customers feel that they are getting the best offer.

Cash discount

Cash discount is referred to the discount that is offered by the seller of a product to the buyer at the time of payment for the purchase. This reduction is provided at the value of the invoice. Cash discount is offered to make the customer or the buyer pay for the product promptly, it helps the business in reducing or avoiding the credit risk completely.

Such discounts are mostly used in business transactions, where a creditor will be reducing the amount to be paid by the debtor, if the payment is processed within the time limit. Proper records are maintained for all such discount transactions both by the buyer and seller.

1.6.3. Differences between trade discount and cash discount

As we have discussed the meaning and example of the two types of discount, now we will move forward to talk about the differences between trade discount and cash discount :

Trade Discount is a subtraction from the list price of the goods, allowed by the trader to the customer at an agreed rate. On the contrary, a Cash Discount is a discount allowed to the customer, when he/she makes cash payment of the goods purchased, within the stipulated time.

Trade discount is based on the amount of purchase or sales, i.e. the more the sales the more will be the rate of discount, whereas cash discount is based on time, i.e. the earlier the payment made by the debtor, the more will be the cash discount allowed.

Trade Discount is always provided to the customer in fixed percentage, whereas the percentage of cash discount may or may not be fixed.

Trade Discount is allowed to the customers because of business considerations like trade practices, bulk orders, etc. Conversely, Cash Discount acts as an incentive or motivation for stimulating payment within the specified time.

Trade Discount is provided to increase sales in bulk quantity, while Cash Discount is given to the customers to encourage early and prompt payment.

Trade discount is allowed on both cash and credit transactions. In contrast, a cash discount is allowed to the customers only on cash payments.

Trade Discount is not specifically shown in the company's financial books, and all the transactions are entered in the purchases or sales book in net amount only.

In contrast, Cash Discount separately appears in the financial books, as an expense in the Profit and Loss Account.

Trade Discount is deducted from the invoice value or catalog price of the goods. As against, Cash Discount is deducted from the invoice value of goods

1.6.4. Provision for discount allowed

Provision for discount allowed is an additional allowance created to adjust the debtor values in addition to losses experienced from the aforementioned cash discount and provision made on doubtful debts.

Provision for discount is recorded in similar way as provision for bad and doubtful debts. It is important to also note that debtors written off are not allowed any discount. The amount set aside as a provision for bad and doubtful debts is therefore exempted from any provision for discount. Then, when calculating the amount of provision for discount, they first must deduct from the debtor, total that amount already provided for bad and doubtful debts.

Application activity 1.6

1. Why do these businesses allow this discount to their customers?
2. What is the impact of this discount allowed to the customers on net profit?
3. Answer by true or false:

   a) Trade Discount is a subtraction from the list price of the goods, allowed by the trader to the customer at an agreed rate. On the contrary, a Cash Discount is a discount allowed to the customer, when he/she makes cash payment of the goods purchased, within the stipulated time

   b) Cash discount is allowed on both cash and credit transactions. In contrast, a trade discount is allowed to the customers only on cash payments.

   c) Trade Discount is provided to increase sales in bulk quantity, while Cash Discount is given to the customers to encourage early and prompt payment.

1.7. Adjusted trial balance

Learning Activity 1.7

The accounting cycle states that after journalizing all business transactions, the ledger account is prepared in order to go on with the preparation of the trial balance. The prepared trial balance is, sometimes inaccurate due to some transactions that need adjustments. Once the adjustments are made, a new trial balance is needed to present a true performance and picture of the company.

1. Is it necessary to prepare the new trial balance after adjustments for the company?
2. In which purpose the adjusted trial balance is prepared?

1.7.1.Meaning of the adjusted trial balance

An adjusted trial balance is a listing of a company accounts that will appear in the financial statement after year-end adjusting entries have been made. Preparing an adjusted trial balance is the fifth step in the accounting cycle and is the last step before financial statements can be produced.

1.7.2. Preparation of the adjusted trial balance

There are two methods for the preparation:

a) **The first method** is similar to the preparation of an unadjusted trial balance. The ledger accounts are adjusted for the end of periods and the account balance is listed to prepare an adjusted trial balance. This method takes a lot of time, but it is very systematic and usually used by large companies where many adjustments need to be made,

b) **The second method** is quite fast and straightforward, but it is not systematic and usually used by small companies where less adjustments need to be done. In this adjustment, entries are directly added to the unadjusted trial balance to convert it to an adjusted trial balance.

Note: in each case, the format of the adjusted trial balance does not differ from that of the unadjusted one. **i.e** any trial balance contains three columns as follow:

a) a column of particulars
b) a column of debit balances
c) a column of credit balances

1.7.3. Purpose of the adjusted trial balance

- The primary purpose of the trial balance is a document that shows the total amount of debit against the total amount of credit. It is not considered as a financial statement because it is only used as an internal document.
- Hence, it is beneficial for big companies to adjust many entries. It also ensures that entries are done correctly; if balances entered into financial statements are incorrect, the financial statements themselves will be inaccurate, and the total must be equal.
- Any difference indicates some error in entries, ledger, or calculations. So it gives a clear picture of the performance and financial position of the company. It also helps to monitor the company's performance as the adjusted trial balance is prepared after considering all adjustments of entries of different accounts.

1.7.4 Difference between trial balance and adjusted trial balance

- The trial balance is prepared first, whereas adjusted trial balance prepared post-trial balance. The trial balance excludes some entries like accrued expenses, accrued income, prepaid income, prepaid expenses and depreciation, whereas adjusted trial balance includes the same.
- A trial balance is a list of closing balances of ledger account on a particular point in time. In contrast, adjusted trial balance is a list of general accounts and their balances at a point of time after the adjusting entries have been posted.

Application activity 1.7

1. Is it necessary to prepare the new trial balance after adjustments for the company?
2. In which purpose the adjusted trial balance is prepared?
3. Give some two aspects of how the adjusted trial balance differs from the unadjusted trial balance

Skills Lab 1

Students in small groups prepare an adjusted trial balance from case studies. Through a case study, students conduct a field visit to school bursar office, check how the students pay the school fees, where they find three different categories of payment: **(i)** some of them, at the end of the term, only totally pay the due amount, **(ii)** other students do not pay in full the due amount, **(iii)** a few number of students pay the total amount due and a part of the coming term.

End unit assessment 1

1. Distinguish bad debts from doubtful debts
2. Answer by yes or no:
   - Accrued income is a current liability
   - Accrued expense is a current asset
   - Prepaid income is a current liability
   - Prepaid expense is a current asset
   - To adjust for accrued expenses, debit the amount outstanding to the respective expenses account and credit it to the liability account
3. In disposal account, the total debit records must be compared to the total credit records. What is the meaning of the equality of total debit records and credit records in the disposal account?
4. At the end of the fiscal year, account receivable has a balance of RWF 100,000 and allowance for doubtful debts account has a balance of RWF 7,000. The expected net realizable value of the account receivable is

   a) RWF 7,000

   b) RWF 93,000

   c) RWF 100,000

   d) RWF 107,000
5. A manufacturing company Ltd acquired a plant for RWF 15,500,000 on 31st August 2015 while its accounting period starts on 1st January every year. The management administration decided to depreciate the plant using declining balance method in 5 years at the end of which, remaining value of the plant will be RWF 5,000,000

   As an accountant of the organization, what is the schedule of the depreciation you propose to administration manager?

Unit 2 FINANCIAL STATEMENTS FOR A SOLE TRADER AFTER ADJUSTMENTS

Key Unit competence: To be able to prepare financial statements of a sole trader after adjustments.

Introductory activity

Joyce, a sole trader in Remera, she records her business transactions daily. After preparing the trial balance for the year 2022, she found out some additional information which caused the trial balance to be adjusted following the accounting cycle. The step of accounting cycle after adjusted trial balance is to prepare financial statements.

Required:

a) As a professional accountant, advice Joyce (sole trader) on the main financial statements that can be prepared for the proper books of accounts of her business.

b) Show the main elements of each financial statement to be prepared by Joyce.

2.1. Income statement/ Statement of Profit or Loss after adjustments

Learning Activity 2.1

ABC business has been performing well almost for five years since 2016 and currently it is experiencing a drop/loss in their profits according to the financial performance for the year 2021. Apart from this drop, after deep checking, some additional information needs adjustments. Owners are complaining about the current performance of their business. As an accountant of ABC Business, explain to the owners about the performance of their business.

a) The loss for the period can be identified using which component of financial statement?

b) Show the main parts/components of statement of profit or Loss.

As seen in Senior 4 unit 10, at the end of year, every business must ascertain its net profit/loss. This is done in two stages.

1. Finding out the Gross Profit / Gross Loss which is got with Trading Account

2. Finding out the Net Profit / Loss which is got with Profit or Loss Account

2..1.1.Determination of Gross Profit /Gross Loss after adjustments

The entries/items that will appear in the Trading Account to ascertain the Gross Profit/Loss will be: (some items will be debited while other will be credited)

i. Items to be debited

1. Opening stock

It speaks of the inventory that was on hand at the start of the prior accounting year. Opening stock is the quantity of an item present at the start of a new period for keeping inventory. It contains the worth of the goods that the company deals in and serves as the opening stock for the current accounting year.

2. Purchases

It refers to the value of goods (in which the concern deals) which are purchased either on cash or on credit for the purpose of resale. The balance of purchases account, appearing in the trial balance, reflects the total purchases made during the accounting period. While dealing with purchases, we must bear in mind the following aspects:

a) Purchase of capital asset should not be added with the purchases. If it is already included in purchases, it should be deducted immediately.

b) If goods are purchased for personal consumption and they are added with the purchases, they should be excluded. These types of purchases should be treated as drawings.

c) If some of goods purchased are still in transit at the year-end, it is better to debit stock-in-transit Account and credit Cash or Supplier's Account.

d) If the amounts of purchases include goods received on consignment, on approval or on hire purchase, these should be excluded from purchases.

e) Cost of goods sent on consignment must be deducted from the purchases in case of trading concern.

3. Sales return/ Return Inwards

In the books of account, Returns Inwards Account or Sales Returns Account is debited and buyer's account is credited. It appears on the debit side of Trial Balance. We can show the sales returns in Trading Account in two ways. It may be shown by way of deduction from sales in the Trading Account. An alternative way to show the sales returns is in the debit side of the Trading Account.

4. Direct expenses/carriage inwards

These types of expenses are directly incurred in connection with purchases, procurement or production of goods. These expenses are directly related to the process of production. They also include expenses that bring the goods up to the point of sale.

ii. Items to be credited

1. Sales

It refers to the sale of goods in which the business deals and includes both cash and credit sales. It does not include sale of old, obsolete or depreciated assets, which were acquired for utilization in business. However, goods sent to customers on approval basis, free samples and sales tax, if any, included in the sales figure should be excluded.

2. Purchases returns

It may come about that due to some reasons: the goods are sent back to the supplier. In that case, the supplier is debited in the books of accounts and purchases returns or returns outwards are credited. It appears on credit side in the trial balance. There are two ways of showing the purchases returns in the income statement. It may be shown by way of deduction from purchases in the income statement. An alternative way is to show the purchases returns in the credit side of the income statement.

3. Closing stock

It refers to the value of goods lying unsold at the end of any accounting year. This stock at the end is called closing stock and is valued at either cost or market price, which is lower. The trial balance generally does not include closing stock. Therefore, the following entry is recorded to incorporate the effect of closing stock in the income statement;

Dr. Closing Stock A/C

Cr. To Trading A/C

However, if closing stock forms a part of Trial Balance, it will not be transferred to Income Statement but taken only to the statement of Financial Position. In case of the goods that have been dispatched to customers on approval basis, such goods should be included in the value of closing stock.

Ascertain the Gross Profit or Loss

After recording the above items in the respective sides of the income statement, the balance is calculated to ascertain Gross Profit or Gross Loss. As seen in Senior 4, if the total of credit side is more than that of the debit side, the excess represents Gross Profit. Conversely, if the total debit side is more than that of the credit side, the excess represents Gross Loss. Remember that the Gross profit is ascertained using the Trading Account.

TRADING ACCOUNT (HORIZONTAL FORMAT)

Name of the company (date/month/year)

	DR		CR
Opening stock	XX	Sales	XX
Purchases	XX	Returns Inwards	(XX)
Add: Carriage Inwards	XX	Net sales	XX
	XX		
Returns Outwards	(XX)		
Cost of goods available for sale	XX		
Closing Stock	(XX)		
Cost of sales	XX		
Gross Profit (Balancing figure)	XX		
	XX		XX

Or

TRADING ACCOUNT (HORIZONTAL FORMAT)

Name of the company (date/month/year)

DR			CR
Opening stock	XX	Sales	XX
Purchases	XX	Returns outwards	XX
Carriage Inwards	XX	Closing stock	XX
Returns inwards	XX		
Cost of sales	XX		
Gross Profit	XX		------
	XX		XX

TRADING ACCOUNT (VERTICAL FORMAT)

TRADING ACCOUNT (VERTICAL FORMAT)	Amount		Amount
Sales			XX
Returns Inwards			(XX)
Net sales			XX
	XX		
Opening stock	XX		
Purchases	XX		
Add: Carriage Inwards	XX		
Returns Outwards	(XX)		
Cost of goods available for sale		XX	
Closing Stock		(XX)	
Cost of sales			(XX)
Gross Profit			XX

Illustration1

From the following details draw up the trading account of Mr Kamanda for the year ended 31st December 2022, which was his first year in business.

	RWF '000'
Carriage inwards	13,400
Returns outwards	9,900
Returns inwards	17,800
Sales	774,800
Purchases	666,660
Stock of goods: 31st December 2022	149,780

Mr Kamanda

Trading Account for the year ended 31 December 2022

		RWF '000'
Sales		774,840
Less: Returns Inwards		(17,800)
Net sales		757,040
Purchases	666,660	
Add: Carriage Inwards	13,400	
Returns Outwards	(9,900)	
Closing Stock	(149,780)	
Cost of sales		(520,380)
Gross Profit		236,660

Or

Mr. Kamanda

Trading Account for the year ended 31 December 2022

		RWF '000'
Sales		774,840
Returns outwards		9,900
Closing Stock		149,780
Purchases	666,660	
Carriage Inwards	13,400	
Returns inwards	17,800	
Gross Profit	236,660	--------
	934,520	934,520

Illustration 2

The following details for the year ended 31st March 2022 are available for Bosco's business. Draw up the Trading account of Bosco for that year.

	RWF '000'
Stock 1 April 2021	16,523
Carriage inwards	1,122
Returns outwards	2,896
Returns inwards	1,372
Sales	94,600
Purchases	53,397
Stock of goods: 31st March 2022	18,504

Bosco

Trading Account for the year ended 31 March 2022

		RWF '000'	RWF '000'
Sales			94,600
Less: Returns Inwards			(1,372)
Net sales			93,228
Opening stock		16,523	
Purchases	53,397		
Add: Carriage Inwards	1,122		
	54,519		
Returns Outwards	(2,896)	51,623	
Cost of goods available for sale		68,146	
Closing Stock		(18,504)	
Cost of sales			(49,642)
Gross Profit			43,586

Determination of net profit (or Loss) after adjustments

After ascertaining the gross profit, the subsequent step is to ascertain net profit or net loss during an accounting period. The net income/profit is measured by matching revenues and expenses. Net income is the difference between total revenues and total expenses.

a) Items to be debited to the Income Statement

i. Management expenses

These are the expenses incurred for carrying out the day-to-day administration of a business. Expenses under this head include office salaries, office rent and lighting, printing and stationery, telegrams, telephone charges etc.

ii. Selling and distribution expenses

These expenses are incurred for selling and distribution of products and services, as the name indicates, they comprise of commissions and salaries of salesmen, advertising expenses, packaging, bad debts etc.

iii.Maintenance Expenses

These expenses are incurred for maintaining the fixed assets of the administrative offices in a good condition. They include expenses towards repairs and renewals.

iv. Financial expenses

These expenses are incurred for arranging finances necessary for running the business. These include interest on loans, discount on bills, brokerage and legal expenses for raising loans etc.

v. Abnormal losses

Some abnormal losses may arise during the accounting period. All types of abnormal losses are treated as unusual expenses and debited to Profit and Loss Account. Examples are stock lost by fire but not covered by insurance, loss on sale of machinery, cash defalcation etc.

vi. Wages and salaries earned by the worker-whether paid or not

N.B: To ascertain the amount of expenses to be debited to the income statement, four types of events are essentially considered and then cash payment is made in connection with these events they are as under:

Expenses incurred and paid out in that year: those will be debited to the income statement.

Expenses incurred but not paid out, partly or fully, during the current year (outstanding expenses): on the date of the final accounts, those are in form of both the expenses and a liability and they exist without having been recorded in the books of accounts. For recording it, the following entry is to be passed:

- **Dr. Expenses A/C Dr.** (will be shown in the income statement account)
- **Cr. Outstanding Expenses** A/C (will appear in the liabilities side of statement of Financial Position)
- **Expenses paid for during the current year, but not incurred as yet, partly or fully (prepaid expenses):** these are assets and will be shown in the Statement of Financial Position.
- **Expenses of the current year, likely to arise in subsequent period:** in such case, we make a provision for the anticipated loss and a charge is created against the profit for the current period. This provision is shown as either a liability or contingent asset, i.e. it appears in the statement of Financial Position as a deduction from some other assets. The best example of this anticipated expense is Provision for Bad Debt.

a) Items to be credited to the Income Statement

i. Other incomes

Sometimes a business might generate some profits, which is not due to the sale of its goods or services because the business may have some other source of financial income. The examples are discount or commission received.

ii. Non-trading Income

The business may have various transactions with the bank. At the end of the year, the business may earn some amount of interest, which will find a place in the profit & Loss Account as non-trading income. The business may have some investment outside the business in the form of shares, debentures or units. All sorts of gains obtained from such kinds of investments are considered as non-trading income and are treated accordingly.

iii.Abnormal gains

There may be capital gains arising during the course of the year, e.g. profit arising out of sale of a fixed asset. The profit is shown as a separate income on the credit side of the Profit & Loss Account. We must remember that all incomes from the abnormal gains or other incomes should be credited to the Profit &Loss Account if they arise of accrues during the period. Similarly, income received in advance should be deducted from the income.

Ascertaining the net Profit &Loss

Once the respective accounts are transferred from trial balance to income statement, gross profit/ loss ascertained and all adjustments are taken care of, the income statement will now be balanced. The totals of incomes and expenses are computed and the difference between these totals is either a net profit or net loss. If the total of expenses exceeds the total of incomes, there is a net Loss, whereas when the total of incomes exceeds the total of expenses, there is a net profit. Net profit/ loss is the last item to be recorded in income statement.

When the Profit and loss account shows a net profit, we pass the following entry:

Dr. Profit &Loss A/C

Cr. Net Profit A/C

If the Profit and Loss Account shows a net loss, the entry will be reserved.

Format of income Statement

The Formats of Statement of Profit or Loss was discussed in S4 Unit 10

Illustration 1

The following trial balance was extracted from the books of Mugabe, a sole trader as at 31st August 2022.

	FRW '000'	FRW'000'
Plant and machinery at cost	11,350	
Provision for depreciation on plant and machinery		4,150
Motor vehicles	13,290	
Provision for depreciation on motor vehicles		2,790
Goodwill	5,000	
Quoted investments	6,470	
Freehold premises at cost	32,000	
Mortgage on premises		10,000
Interest paid/ received	1,000	460
Inventory	4,670	
Bank and cash	2,850	
Capital		60,000
Drawings	5,600	
Purchases/sales	34,260	58,640
Returns inwards and outwards	3,260	2,140
Carriage inwards	730	
Carriage outwards	420	
Discount allowed/received	1,480	1,970
wages	7,180	
Rates and rent	4,300	
Allowance for bad debts		530
Trade receivable/payable	7,300	4,340
Electricity	2,640	
Stationery	450	=
Bad debts	770	
	145,020	145,020

Additional information

1. Inventory as at 31st August 2022 was valued at FRW 3,690,000
2. Allowance for bad debts is to be adjusted at 10 % of debts
3. Goods which costed FRW 300,000 had erroneously been invoiced to a customer for FRW 400,000 and had been accounted for in sales
4. Electricity accrued as at 31st August 2022 was FRW 130,000 and prepaid rates amounted to FRW 210,000 as at 31st August 2022
5. Stock of stationery as at 31st August 2021 was FRW 230,000
6. Depreciation is to be provided on pro rata basis as follows:
   - Motor vehicles 20% on reducing balance method
   - Plant and machinery 25% on reducing balance
7. A motor vehicle was sold on credit on 1st December 2021 for FRW 458,000. The motor vehicle had been bought on 1st June 2020 for FRW 1,000,000 the sale had not been recorded to the ledger., proportionate depreciation is applicable until disposal date
8. During the year, Mugabe took goods worth FRW 350,000 from the business for his own use.

Required: Prepare Income Statement/ Statement of Profit or Loss for the year ended 31st August 2022

Solution

Workings:

1. Provision for bad debts = 7,300,000*10% = 730,000

   Increase in previous for bad debts = 730,000 - 530,000 = 200,000
2. Motor vehicle depreciation:

1st period of 3 months	20%*1,000,000*3/12	50,000
2nd period full year	20%*(1,000,000 - 50,000)	190,000
3rd period	20% (1,000,000-50,000 - 190,000) *3/12	38,000
		278,000

NBV = 1,000,000 – 278,000 = 722,000

3. Disposal of motor vehicle account

	FRW 000		FRW'000'
Motor vehicle	1,000	Prov. For depre.	278
		Bank	458
		Income statement	264
1,000			1,000

4. Electricity account

	FRW'000'		FRW '000'
Cash	2,640	Income statement	2,770
Balance c/d	130		
	2,770		2,770

5. Rent and rates account

	FRW'000'		FRW '000'
Cash	4,300	Income statement	4,090
		Balance c/d	210
	4,300		4,300

1. Stationary = 450 – 230 = 220
2. Depreciation

Plant and machinery = 25%(11,350,000 - 4,150,000) = 1,800,000

Motor vehicle = 20% ((13,290,000-1,000,000) -(2,790,000-278,000)) = 1,955,600

Mugabe Income statement/ statement of Profit or Loss for the year ended 31st August 2022

	FRW'000'	FRW'000'
Sales		58,640
Return inwards		(3,260)
Net sales		55,380
Cost of sales:		
Opening inventory	4,670	
Purchases	34,260	
Returns outwards	(2,140)	
Drawings	(350)	
Goods available for sales	36,440	
Carriage inwards	730	
Closing inventory	(3,690)	(33,480)
Gross profit		21,900
Incomes:		
Discount received		1,970
Interest received		460
Expenses:		
Stationery (w6)	220	
Electricity (w4)	2,770	
Loss on sale of vehicle (w3)	264	
Increase in all of for doubtful debt (w1)	200	
Rent and rates (w5)	4,090	
Wages	7,180	
Discount allowed	1,480	
Carriage outwards	420	

	FRW '000'	FRW'000'
Interest	1,000	
Depreciation:		
Plant and machinery (w7)	1,800	
Motor vehicle (w7)	1,955.6	
Bad debt	770	
Total expenses		**(22,149.6)**
NET PROFIT		**2180.4**

Illustration 2

The following trial balance was extracted from the books of MIRIMO, a sole trader for the year ended 31st December 2020

	FRW '000'	FRW'000'
Capital		5,920,000
Drawings	1,200,000	
Trade debtors	1,808,400	
Trade creditors		2,169,000
Sales		8,892,600
Purchases	4,188,400	
Stock-1st January 2020	2,533,300	
Sales returns	144,700	
Purchases returns		218,800
Cash in hand	56,800	
Balance at bank	1,056,400	
Warehouse expenses	640,000	
Discounts allowed	90,200	
Discounts received		170,000

	FRW ‘000’	FRW’000’
Office salaries	600,000	
Office lighting	188,800	
Rates	108,200	
Motor vehicles (cost)	1,280,000	
Freehold premises (cost)	2,600,000	
Fixtures and fittings	576,000	
General expenses	142,400	
Insurance	28,000	
Provision for bad debts		50,000
Motor vehicle expenses	150,000	
Bad debts written off	28,800	
Total	**17,420,400**	**17,420,400**

Additional information:

1. Stock as at 31st December 2020 was valued at FRW 1,760,000
2. Depreciation on fixtures and fittings and motor vehicle is to be provided at the rate of 5% and 10 % per annum respectively
3. Rates prepaid as at 31st December 2020 amounted to FRW 25,600,000
4. Unexpired insurance as at 31st December 2020 is to be made at FRW 4 Million.
5. Additional FRW 1,758,240 Discount received is to be made

Required:

Prepare Statement of Profit or Loss for the year ended 31st December 2020

Solution

MIRIMO

Statement of Profit or Loss for the year ended 31December 2020

	FRW '000'	FRW '000'	FRW '000'
Sales			8,892,600
Sales returns			(144,700)
Net sales			8,747,900
Cost of sales			
Opening stock		2,533,300	
Purchases	4,188,400		
Purchases returns	(218,800)	3,969,600	
Closing stock		(1,760)	(6,501,140)
Gross profit			2,246,760
Discount received			1,928,240
			4,175,000
Expenses			
Bad debts		28,800	
Warehouse expenses		640,000	
Discount allowed		90,200	
Office salaries		600,000	
Office lighting		188,800	
Rates: paid	108,200		
Prepaid	(25,600)		
		82,600	
Depreciation (w2) Motor Vehicle		128,000	
Fixtures and fittings		28,800	
General expenses		142,400	
Insurance: paid	28,000		
Unexpired	(4,000)		
		24,000	
Motor vehicle expenses		150,000	
Total Expenses			2,103,600
Net profit			2,071,400

Illustration 3

The following balances were extracted from ENOCK's accounting books at the end of the financial year on 30th June 2020.

	FRW
Vehicles, cost	25,000,000
Furniture and fittings, cost	10,000,000
Patents	1,000,000
Opening stock	5,000,000
Purchases	120,000,000
Sales	135,000,000
Sales returns	5,000,000
Purchases returns	2,000,000
Prepaid insurance	4,000,000
V.A.T. payable	2,000,000
Wages and salaries	6,000,000
Bad debts	500,000
Provision for bad debts	1,500,000
Office expenses	1,200,000
Trade creditors	3,600,000
Trade debtors	5,000,000
Rent	2,400,000
Cash in hand	2,500,000
Bank (current account balance) –debit balance as per cash book	6,500,000
Carriage	800,000
Commission revenue	500,000
Drawings	700,000

	FRW
Loan from cousin	3,000,000
Capital	42,000,000
Accumulated depreciation:	
- Vehicles	5,000,000
- Furniture and fittings	1,000,000

Additional information

a) Stock of goods in trade was valued at FRW 1,800,000 at the end of the year

b) FRW 300,000 of the carriage relates to purchases and the balance relates to sales

c) Enock receives a commission of 1% of gross purchases. The outstanding balance of the commission for the year ended is to be received on 5th day of the following financial year.

d) The provision for bad debts is to be reduced by 10% of the trade debtor's figure

e) Rent was paid on the first day of the financial year to cover a period of 18 months.

f) The loan from cousin was acquired on 1st January (within the financial year), it is at interest rate of 20% per annum. Interest due for the period is outstanding.

g) Vehicles are to be depreciated by 20% per annum on reducing balance method and furniture and fittings by 10% per annum on cost.

h) Prepaid insurance of FRW 1,000,000 expired on 30th June 2020 (the last day of the financial year).

Required:

a) a) Journal entry to record adjusting information c-h

b) b) Statement of Profit or Loss (Income Statement) for the year ended 30th June 2020.

Solution:

Enock

Journal entries to record Adjusting information on 30/6/2020

C	Commission receivable Commission revenue	1,200,000	 1,200,000
D	Provision for bad debts P&L (Reduction in Bad debts Prov.)	500,000	 500,000
E	Prepaid rent Rent	800,000	 800,000
F	Loan interest Loan interest payable	300,000	 300,000
G	Depreciation expense: vehicles Accumulated depreciation: vehicles	4,000,000	 4,000,000
	Depreciation expenses: Furniture and fittings Accumulated Depreciation: Furniture &fitting	1,000,000	 1,000,000
H	Insurance Prepaid insurance	1,000,000	 1,000,000

Enock

Statement of Profit or Loss for the year ended 30/6/2020

	RFW '000'	FRW'000'	FRW'000'
Sales			135,000
Less: sales returns			(5,000)
Net sales			130,000
Less: Cost of goods sold			
Opening stock 1/7/2019		5,000	
Add: purchases	120,000		
Add: carriage on purchases	300		

	RFW '000'	RFW '000'	RFW '000'
	120,300		
Less: Purchases returns	2,000		
Net purchases		118,300	
		123,300	
Less: closing stock		1,800	
Cost of goods sold			121,500
Gross profit			8,500
Add: Miscellaneous incomes:			
Reduction in provision for bad debts		500	
Commission revenue		1,200	1,700
			10,200
Less: operating expenses:			
Insurance		1,000	
Wages and salaries		6,000	
Bad debts		500	
Office expenses		1,200	
Rent		1,600	
Carriage on sales		500	
Loan interest		300	
Depreciation			
-Vehicles		4,000	
- Furniture and fittings		1,000	16,100
NET LOSS			**(5,900)**

Income statement/ Statement of Profit or Loss in service firms

The income statement/ Statement of Profit or Loss for service sector firms e.g. banks; insurance companies, etc are simple to draw up as it does not contain the trading Account. Their formats are shown as follows:

Statement of Profit or Loss

Incomes/revenues	XX
Less: expenditures:	XX
Net Profit before tax	XX
Less: provision for corporation tax	XX
Net profit after tax	XX

Illustration 4

Peter, a consultant in accountancy services prepared the following trial balance for his Door way consultancy for the financial year ended 31/8/2019

	Dr. FRW '000'	CR '000'
Cash balance	14,000	
Bank balance		5,000
Land, cost	100,000	
Motor vehicle, cost	50,000	
Furniture and fittings, cost	20,000	
Earned Consultancy fees		139,500
Unearned Consultancy fees (Creditors		4,000
Consultancy fees Receivable (debtors)	8,000	
Rent	6,000	
Electricity	2,000	
Insurance	3,000	
Salaries and wages	15,000	

	Dr. FRW '000'	CR '000'
Water and telephone	4,000	
Office supplies	2,500	
10% BK Loan		30,000
Capital		40,000
Drawings	1,000	
Accumulated depreciation:		
-Motor Vehicle		5,000
Furniture and fittings	---------	2,000
	225,500	225,500

Information for adjustments at the end of the year

1. Consultancy fees of FRW 2,000,000 which were unearned were earned on 31/8/2019. The trial balance does not reflect this information.
2. Customers who were provided with services during the year ended to June 2019 amounting to FRW 3,500,000 were not yet invoiced by 31/8/2019.
3. Hand count of office supplies on 31/8/2019 revealed that office supplies worth FRW 500,000 remained in inventory
4. Depreciate Furniture and fittings and motor vehicles by 10% on cost
5. Loan interest for one year accrued
6. Electricity bills amounting to FRW 1,500,000 remained outstanding on 31/8/2019
7. A provision of corporation tax to be paid at the rate of 30% of pre-tax net profit should be made.

Required:

Statement of Profit or Loss of Peter's Consultancy at the end of the Financial Year on 31/8/2019

Solution

Door way Consultancy Income Statement/ Statement of Profit or Loss for the period ended 31/8/2019

	FRW '000'	FRW '000'
Incomes:		
Earned Consultancy fees		139,500
Less: operating expenses:		
Rent	6,000	
Electricity 2,000 + 1,500	3,500	
Insurance	3,000	
Salaries and wages	15,000	
Water and telephone	4,000	
Office supplies (2,500-500)	2,000	
Loan interest	3,000	
Depreciation:		
Motor vehicle	5,000	
Furniture and fittings	2,000	(43,500)
Pre-tax net profit		96,000
Less: corporation tax provision (30%)		(28,800)
Net profit after tax		**67,200**

Application activity 2.1

Mr Amandi has been trading for some years as Wine merchant. The following list of balances has been extracted from his ledger as at 30 April 2020, the end of his financial year.

	FRW
Capital	83,887
Sales	259,870
Trade creditors	19,870
Returns out	13,407
Provisions for bad debts	512
Discount allowed	2,306
Discount received	1,750
Purchases	135,680
Returns in	5,624
Carriage outwards	4,562
Drawings	18,440
Carriage inwards	11,830
Rent, rates and insurance	25,973
Heating &lighting	11,010
Postage, stationery and telephone	2,410
Advertising	5,980
Salaries & wages	38,521
Bad debts	2,008
Cash in hand	538
Cash at bank	4,440
Stock at 1 May 2020	15,654
Trade debtors	24,500
Fixtures& fittings at cost	120,740
Provision for depreciation on fixture & fittings (30/4/2021)	63,020
Depreciation	12,074

Additional information:

a) Stock at the close of business was valued at FRW 17,750.

b) Insurance has been prepaid by FRW 1,120

c) Heating and lighting is accrued by FRW 1,360

d) Rates have been prepaid by FRW 5,435

e) The provision for bad debts is to be adjusted so that it is 3% of trade debtors

REQUIRED: Prepare Mr Amandi's trading, profit and Loss account for the year ended 30 April 2020.

2.2. Balance sheet (statement of Financial position) after adjustments

Learning Activity 2.2

A local business located in Nyabihu District owned by Annette collects and distributes Irish potatoes. At the end of 2022, while closing the financial period, Annette was not aware on the statement to be prepared. You are asked

1. To advise her on which statement to be prepared in order to know the financial position of her business.

A Statement of Financial Position is a summary of the financial balances of a sole proprietorship, business partnership or a company. It is a statement that helps us to establish the financial position of a business enterprise on a particular date, i.e. on a date when financial statements or final accounts are prepared or books of accounts are closed.

In facts, this statement treats the balances of all those ledger accounts that have not yet been squared up. These accounts relate to assets owned, expenses due but not paid, incomes accrued but not received or certain receipts which are not due or accrued. In other words, it deals with all those real and personal accounts which have not been accounted for in trading or Profit & Loss accounts. Therefore, an important feature of a statement of financial position is to show the exact financial picture of a business concern on a particular date.

2.2.1. Difference between trial balance and Statement of Financial Position

	Trial balance	Statement of Financial Position
1	The purpose of preparing a trial balance is to check the arithmetical accuracy of account books	A statement of financial position is drafted to reveal the financial position of the business
2	A trial balance is prepared to document that the total amount of account balances with debit balances is equal to the total amount of account balances with credit balances	A Statement of Financial position shows that the total of the asset amounts is equal to the total of the amounts of liabilities and stockholders' equity.
3	It is prepared before the preparation of income statement Account.	It is prepared after the preparation of income statement Account.
4	It does not contain the value of closing stock of goods.	It contains the value of the closing stock, which appears on the assets side.
5	Expenses due but not paid and incomes due but not received do not appear in the Trial Balance	Expenses due but not paid appear on the liability side and incomes due but not received appear on the asset side of Statement of Financial position.
6	In case of trial Balance, the columns are named as debit and credit columns.	The two sides of Statement of financial position are called liabilities and assets sides respectively.
7	It is a list of balance extracted from the ledger accounts.	It contains the balance of only those accounts, which represent assets and liabilities.
8	It contains the balance of all accounts-real, nominal and personal.	It contains the balance of only those accounts, which represent assets and liabilities.

2.2.2. Preparation and presentation of statement of Financial position

The process of preparation and presentation of statement of financial position involves two steps:

- Grouping
- Marshalling

Grouping

In the first step, the different items to be shown as assets and liabilities in the Statement of Financial Position are grouped appropriately. For this purpose, items of similar nature are grouped under one head so that the Balance Sheet could convey an honest and true message to its users. For example, stock, debtors, bills receivables, bank, cash in hand etc. are grouped under the heading **current Assets** and land and Building, plant and Machinery, Furniture and fittings, tools and equipment under **Non-Current Assets**. Similarly, sundry creditors for goods must be shown separately and distinguished from money owing, other than due to credit sales of goods.

Marshalling

The second step involves marshalling of assets and liabilities. This involves a sequential arrangement of all the assets and liabilities in the statement of Financial Position. There are two methods of presentation:

- The order of liquidity
- The order of permanence

Under liquidity order, assets are shown on the basis of liquidity or reliability. These are rearranged in an order of most liquid, more liquid, liquid, least liquid and not liquid (fixed) assets. Similarly, liabilities are arranged in the order in which they are to be paid or discharged.

Under order of permanence, the assets are arranged on the basis of their useful life. The assets predicted to be most fruitful for the business transaction for the longest duration will be shown first. In other words, this method puts the first method in the reverse gear. Similarly, in case of liabilities, after capital, the liabilities are arranged as long term, medium term, short term and current liabilities. This is the commonly used method.

Classification of assets

1. Non-current assets
2. Intangible assets
3. Current assets
4. Fictitious assets

5. Wasting assets
6. Contingent assets

i. Non-current assets

These are those assets, which are acquired for the purpose of producing Goods or rendering services. These are not held for resale in the normal course of business. Fixed assets are used for the purpose of earning revenue and hence these are held for a longer duration. Investment in these assets is known as 'Sunk Cost". All fixed assets are tangible by nature.

ii. Intangible assets

Intangible assets are those capital assets, which do not have any physical existence. Although these assets cannot be seen or touched, they are long lasting and prove to be profitable to owner by virtue of the right conferred upon them by mere possession.

They also help the owner to generate income. Goodwill, trademarks, copyrights and patents are the example of intangible assets.

iii.Current assets

Current assets include cash and other assets, which are converted or realized into cash within a normal operating cycle or say, within a year.

Current assets are also known as Floating Assets or Circulating Assets.

iv. Liquid or quick assets

These are current assets that can be converted into cash at a very short notice or immediately, without incurring much loss or exposure to high risk. Quick assets can be worked out by deducting Stock (raw materials, work-in-progress or finished goods) and prepaid expenses out of total current assets.

v. Fictitious assets

These are the non-existent worthless items which represent unwritten-off losses or costs incurred in the past, which cannot be recovered in future or realized in cash. Examples of such assets are preliminary expenses (formation expenses), advertisement expense, underwriting commission, discount on issue of shares and debentures, Loss on issue of debentures and debit balance of income statement account. These fictitious assets are written off or wiped out by debiting them to income statement account.

vi. Wasting assets

An asset that has a limited life and therefore windless in value over time it is called wasting asset. This type of asset has a limited useful life by nature and depletes over a limited duration. These assets become worthless once their utility is over or exhausts. During the life of productive usage, assets of this type produce revenue, but eventually reach a state where the worth of the assets begins to diminish. Such assets are natural resources like timber and coal, oil, mineral deposits etc.

vii. Contingent assets

Contingent assets are probable assets, which may or may not become assets, as that depends upon occurrence or non-occurrence of a specified event or performance or non-performance of a specified act. For example, a suit is pending in the court of law against ownership title or a disputed property. If the business does not win the lawsuit, it will not have ownership rights of the property; it will be of no use to it. However, if it wins, the contingent asset will become the asset of the concern. Such assets are shown by means of footnotes and hence do not form part of assets shown in the Balance Sheet.

Besides this, hire- purchase contract, uncalled share capital etc… are other examples of contingent assets.

Classification of liabilities

i. Non-current liabilities/long-term liabilities

ii. Current liabilities

iii. Contingent liabilities:

Contingent liability is an actual liability but anticipated (probable) liability which may or may not become payable. It depends upon the occurrence of certain events or performance of certain acts. If a parent guarantees a daughter's first car loan, the parent has a contingent liability. Contingent liabilities are shown as footnotes under the statement of financial position.

Illustration1. From illustration 2 in 2.1., prepare Mirimo's Statement of Financial Position

Solution

MIRIMO

Statement of Financial Position

	Cost FRW'000'	**Acc. Dep FRW'000'**	**NBV FRW'000'**
Non-current assets:			
Motor vehicles	1,280,000	128,000	1,152,000
Freehold premises	2,600,000		2,600,000
Fixtures and fittings	576,000	28,800	547,200
	4,456,000	156,000	4,299,200
Current assets:			
Stock		1,760,000	
Debtors	1,808,400		
Provision for bad debts	(50,000)	1,758,400	
Cash at bank		1,056,400	
Cash in hand		56,800	
Prepayments 25,600 + 4,000		29,600	4,661,200
			8,960,400
Liabilities:			
Creditors			2,169,000
Financed by:			
Capital		5,920,000	
Drawings		(1,200,000)	
Net profit		**2,071,400**	6,791,400
			8,960,400

2.2.3. Prepare the Statement of Financial Position showing working capital and capital employed

Types of capital

Different types of capital can be calculated as below:

i. Capital net worth/owned = total assets + total liabilities. The capital net worth is also referred to as net worth or net assets

ii. Working capital = current assets – current liabilities

Working capital = capital employed –fixed assets

iii. Capital employed = total fixed assets + working capital or

Capital employed = owner's equity + Long term liabilities

Illustration 2

Prepare the Statement of Financial Position of Enock for the period ended 31/6/2020 from illustration 3 in 2.1.

Solution

ENOCK

Statement of Financial Position as at 31/6/ 2020

	Cost FRW '000'	Acc. dep. FRW '000	NBV FRW '000'
Fixed assets:			
Furniture and fittings	10,000	2,000	8,000
Vehicles	25,000	9,000	16,000
	35,000	11,000	24,000
Intangible assets:			
Patents			1,000
Current assets:			
Closing stock		1,800	
Trade debtors	5,000		
Less: provision for bad debts 1,500 - 500	1,000	4,000	

	Cost FRW '000'	Acc. dep. FRW '000	NBV FRW '000'
Commission receivable		700	
Prepayments:			
Insurance		3,000	
Rent		800	
Bank-current account		6,500	
Cash in hand		2,500	
		19,300	
Less: current liabilities:			
VAT payable	2,000		
Trade creditors	3,600		
Loan interest payable	300	5,900	
Working capital (Net current assets)			13,400
NET ASSETS (WORTH)			38,400
Financed by:			
Capital			42,000
Less: Net Loss		5,900	
Drawings		700	(6,600)
Owner's Equity			35,400
Long-term liabilities:			
Loan from cousin			3,000
CAPITAL EMPLOYED			38,400

Application activity 2.2

1. At 31st March 2022 Shalon was owed FRW 47,744,000 by her customers. At the same date her allowance for receivables was FRW 3,500,000. How should these balances be reported on Shalon's Statement of Financial position?

   i. FRW 44,244,000 as a current asset

   ii. FRW 3,500,000 as a current asset and FRW 47,744 as a current liability

   iii. FRW 47,7444 as a current asset and FRW 3,500,000 as a current liability

   iv. FRW 51,244,000 as a current asset

2. From the illustration 4 in 2.1. Prepare door Consultancy Balance Sheet as at 31/8/2019

2.3. Cash-Flow Statement (Statement of Cash-Flow)

Learning Activity 2.3

Visit your neighboring company and ask the accountant to show you the school financial Statements.

a) Check on them differently and find which statement that shows the movement of cash.

b) You will find different parts and elements in the statement of cash flow. How do we call the cash that are coming in business, cash that are going out the business and their difference?

In senior four, the direct method of cash flow statement was discussed on, that is why only indirect method will be seen.

Rules of preparing statement of cash flow in indirect method

Although the Financial Accounting Standard Board favors the direct method for preparing the statement of cash flows, most companies do not use the direct method opting instead for the indirect method because it is easier to prepare and provides less detailed information to competitors.

Under the indirect method, the cash flow statement begins with net income

on an accrual basis with assumption that net income equals cash and subsequently adds and subtracts non-cash items to reconcile to actual cash flows from operations. An increase in an asset account is subtracted for net income, and an increase in a liability account is added back to net income.

The following rules can be followed to calculate **Cash Flows from Operating Activities** when given only a two-year comparative balance sheet and the Net Income figure.

- Decrease in non-cash current assets are added to net income
- Increase in non-cash current asset are subtracted from net income
- Increase in current liabilities are added to net income
- Decrease in current liabilities are subtracted from net income
- Expenses with no cash outflows are added back to net income (depreciation and/or amortization expense are the only operating items that have no effect on cash flows in the period)
- Revenues with no cash inflows are subtracted from net income
- Non-operating losses are added back to net income
- Non-operating gains are subtracted from net income

It is important to understand why certain items are added and others subtracted. Note the following points:

a) Depreciation is not a cash expense, but is deducted in arriving at profit. It makes sense, therefore, to eliminate it by adding it back.

b) By the same logic, a loss on disposal of a non-current asset (arising through under provision of depreciation) needs to be added back and a profit deducted.

c) An increase in inventories means less cash you have spent cash on buying inventory.

d) An increase in receivables means the company's debtors have not paid as much and therefore there is less cash.

e) If we payoff payables, causing the figure to increase, again we have less cash.

Rules (Financing Activities)

Finding the Cash Flows from Financing Activities is much more intuitive and needs little explanation. Generally, the things to account for are financing activities:

- Include as outflows, reductions of long term note payable (as would represent the cash repayment of debt on the balance sheet)
- Or as inflows, the issuance of new notes payable
- Include as outflows, all dividends paid by the entity to outside parties
- Or as inflows, dividend payments received from outside parties
- Include as outflows, the purchase of notes stocks or bonds
- Or as inflows, the receipt of payments on such financing vehicles.
- In the case of more advanced accounting situations, such as when dealing with subsidiaries, the accountant must:
- Exclude intra-company dividend payments.
- Exclude intra-company bond interest

Preparation of Statement of Financial Statement using indirect method

Format of cashflow statement (indirect method)

Cash flow from operating activities:		
Net profit before tax		XX
Add:		
Depreciation	XX	
Goodwill W/O	XX	
Intangible fixed assets W/O	XX	
Loss on disposal	XX	XX
Less:		
Gain on disposal	XX	
Gain on investment	XX	(XX)
Adjusted Net profit		XX
Decrease in current assets		**XX**

Cash flow from operating activities:		
Net profit before tax		XX
Add:		
Depreciation	XX	
Goodwill W/O	XX	
Intangible fixed assets W/O	XX	
Loss on disposal	XX	XX
Less:		
Gain on disposal	XX	(XX)
Gain on investment	XX	
Adjusted Net profit		**XX**

N.B Further details on components of cash flow (cash flow from operating activities, cash flow from investing activities and financing activities) are discussed in Senior 4 unit 10.

Illustration 1

The following are balance sheets of Neema private ltd for the years ended 31st Dec 2003 and 2004 respectively.

Balance sheet/ statement of financial position as at 31st Dec 2003

	FRW '000'	**FRW 000'**	FRW '000'
Non-current assets	Cost	**Accumulated dep.**	Net
Land	1,500		1,500
Furniture	380	(40)	340
Motor vehicles (NBV)			550
			2,390
Investment			200
			2,590
Current assets			
Stock		670	
Debtors		490	
Cash		30	
		1,190	
Current liabilities			
Creditors	740		
Bank overdraft	40	(780)	410
Non-current liabilities			
Bank loan			(500)
			2,500
Financed by Capital			2,500

Neema private ltd

Balance sheet/ Statement of Financial Position as at 31st Dec 2004

	FRW '000'	FRW '000'	FRW '000'
Non-current assets	**Cost**	**Accumulated dep.**	**Net**
Land & premises	1,200		1,200
Furniture	380	(100)	280
Motor vehicles (NBV)			880
			2,360
Current assets			
Stock		570	
Debtors		690	
Bank		15	
Cash		5	
		1,280	
Current liabilities			
Creditors	(780)		
Bills payable	(240)	(1,020)	260
			2,620
Financed by Capital			2,500
Net profit			200
Fresh capital			100
			2,800
Drawings			(180)
			2,620

Additional information:

i. A piece of land was sold in July 2004 for FRW 610,000 and investment in October 2004 for FRW 175,000

ii. Some motor vehicle was bought in 2004 for FRW 520,000. No furniture was bought or sold during the year.

iii. Profit before tax for the year ended on31 December 2004 was FRW 200,000

Required: Statement of Cash Flow to explain the change in cash

Solution

Adjustments:

a) Gain on disposal (land) = 610,000-(1,500,000-1,200,000) = 610,000-300,000=310,000
b) Loss on disposal (investment) = 200,000 - 175,000 = 25,000
c) Depreciation on furniture= 100,000-40,000=60,000
d) Depreciation on Motor Vehicle= 520,000-(880,000-550,000) =190,000

Neema private ltd

Statement cash flow (indirect method)

	FRW	FRW
Net cash flow from operating activities		200,000
Add: Depreciation on furniture		60,000
Depreciation of motor vehicles		190,000
Loss on disposal of investment		25,000
Increase in creditors		40,000
Decrease in stock		100,000
Increase in bills payable		240,000
		855,000
Less:		
Profit on sale of land		310,000
Increase in debtors		200,000

	FRW	FRW
Net cash flow from operating activities		345,000
Investing activities:		
Sale on land	610,000	
Sale of investments	175,000	
Purchases of motor vehicles	(520,000)	265,000
Financing:		
Fresh capital	100,000	
Repayment bank loan	(500,000)	
Drawings	(180,000)	(580,000)
Cash and cash equivalent for the period		30,000
Cash and cash equivalent at the beginning (30,000-40,000)		(10,000)
Net cash position		20,000

Dells Company started its business on 1st July 2014 and it is operating its business activities nearby your school. At the 30 June, its accountant presented the business's Balance Sheet for two years (2014 and 2015) which follows:

Dells Company Comparative Balance Sheet June 30 2015 and 2014			
	2015	**2014**	**Increase (Decrease)**
Assets	Frw	Frw	Frw
Current Assets:			
Cash	30,000	80,000	(50,000)
Accounts Receivable, Net	160,000	100,000	60,000
Merchandise Inventory	100,000	70,000	30,000
Prepaid Rent	20,000	10,000	10,000
Total Current Assets	310,000	260,000	
Property, plant, and equipment:			
Equipment	40,000	20,000	20,000
Accumulated Depreciation – Equipment	(60,000)	(50,000)	(10,000)
Total Property, plant, and equipment	340,000	150,000	
TOTAL ASSETS	**650,000**	**410,000**	
Liabilities and Equity			
Current Liabilities:			
Accounts Payable	50,000	40,000	10,000
Notes Payable – bank	-	50,000	(50,000)
Salaries Payable	10,000	20,000	(10,000)
Taxes Payable	30,000	20,000.00	10,000
Total Current Liabilities	90,000	130,000	
Stockholder's Equity:			
Common stock, 10Frw	300,000	100,000	200,000
Paid in capital in excess of par, Common	50,000	0	50,000
Retained earnings	210,000	180,000	30,000
Total Stockholder's Equity	560,000	280,000	
TOTAL LIABILITIES AND EQUITY	**650,000**	**410,000**	

Required: Prepare Dells Statement of Cash Flow for the year ended 30 June 2015 using indirect method.

Answer

Dells Company		
Statement of Cash Flows For Year Ended June 30, 2015		
Cash flows from operating activities:		
Net Income		70,000
Adjustments to reconcile net income to net cash:		
Depreciation expense	20,000	
Loss on sale of equipment	7,000	
Increase in Accounts Receivable	(60,000)	
Increase in Merchandise inventory	(30,000)	
Increase in Prepaid rent	(10,000)	
Increase in Accounts Payable	10,000	
Decrease in Salaries Payable	(10000)	
Increase in Federal income Taxes Payable	10,000	
Total adjustments		(63,000)
Net cash provided by operating activities		**7,000**
Cash flows from investing activities:		
Cash received from sale of equipment	3,000	
Cash paid for new equipment	(220,000)	
Net cash used by investing activities		**(217,000)**
Cash flows from financing activities:		
Cash paid for notes payable	(50,000)	
Cash received from issuing stock	250,000	
Cash paid for dividends	(40,000)	
Net cash provided by financing activities		160,000
Net Increase (or Decrease) in Cash		(50,000)
Cash Balance, 2014		80,000
Cash Balance, 2015		**30,000**

Application activity 2.3

1. Outline the uses of statement of cash flow to the visited business.

2. Maria is a sole trader who prepares his accounts annually to 30 April. His summarized balance sheets for the last two years are shown:

Balance sheets as at 30 April

	2014		2015	
	FRW	FRW	FRW	FRW
Non-current assets:		155,000		185,000
Less: provision for depreciation		15,000		17,000
		140,000		168,000
Current assets:				
Stocks	31,000		59,000	
Trade debtors	39,000		34,000	
Bank	15,000		-	
	85,000		93,000	
Current liabilities:	(20,000)		(31,000)	62,000
		205,000		230,000
Financed by:				
Capital account				
Balance 1 May		200,000		205,000
Add: net profit for the year		70,000		85,000
Additional capital introduced		-		20,000
		270,000		310,000
Drawings		(65,000)		(80,000)
		205,000		230,000

You are required to prepare the statement of Cash Flow as at 30 April 2015

Skills Lab

After visiting any neighboring sole proprietorship business and checking its financial statements,

1. Outline different Financial Statements prepared by a sole trader
2. Discuss about the use of financial statements to the visited business
3. As an accountant, advice the sole traders on the impact of negligence in the preparation of Financial Statements.

End unit assessment 2

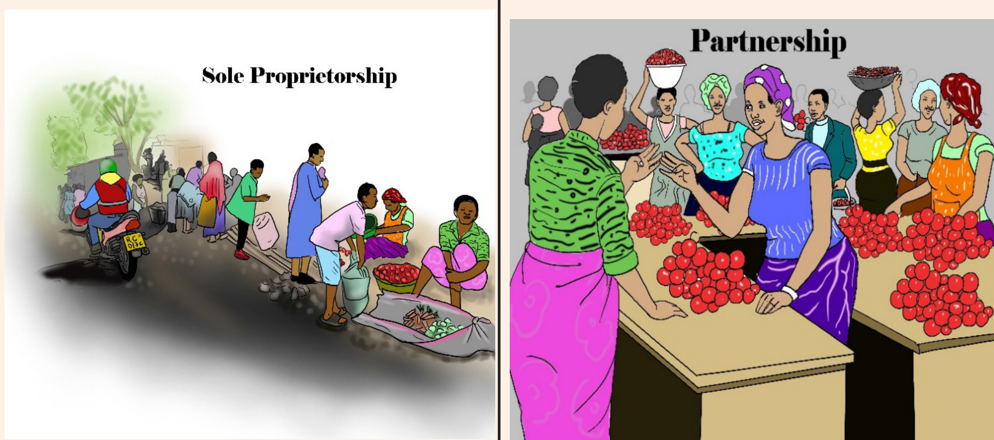
1. Explain three reasons why the amount of cash flow of a business entity might differ from the profit generated by the business entity during the same period.
2. The book keeper of Mella Enterprise Ltd prepared the following trial balance for the financial year ended31st march 2020

	Dr. FRW	Cr. FRW
Cash	800,000	
Bank	2,500,000	
Debtors	3,000,000	
Stock 1/4/2019	600,000	
Vehicle, cost	7,000,000	
Equipment, cost	5,000,000	
Purchases	4,000,000	
Wages	1,000,000	
Electricity	200,000	
Rent	700,000	
Bad debts	30,000	

Unit 3 PARTNERSHIP ACCOUNTS

Key unit competence: To be able to prepare financial statements for a partnership business

Introductory activity



Observe the picture above and answer the following questions:

1. What do you see on this image?
2. Among forms of business, which one is formed by partners?
3. What do you understand by partnership agreement?
4. Which accounts to be prepared in partnership

3.1. Introduction to partnership

Learning Activity 3.1

Read the following case study and answer the given questions.

A partnership is a business owned by two or more people. In most forms of partnerships, each partner has unlimited liability for the debts incurred by the business. The three most prevalent types of for-profit partnerships are: general partnerships, limited partnerships, and limited liability partnerships. Partnerships are arrangements between individuals to carry on business in common with a view to profit. A partnership, however, involves obligations to others, and so a partnership is usually governed by a partnership agreement. Unless it is a limited liability partnership (LLP), partners will be fully liable for debts and liabilities, for example if the partnership issued. A partnership is a group of individuals who are trading together with the intention of making a profit. Partnerships are often created as a sole trader's business expands and more capital and expertise are needed within the business. Typical partnerships are those of accountants, solicitors and dentists and usually comprise between about 2 and 20 partners. As partnerships tend to be larger than sole traders, there will usually be more employees and a greater likelihood of a bookkeeper being employed to maintain the accounting records. Each of the partners will contribute capital to the business and will normally take part in the business activities. The profits of the business will be shared between the partners, and this is normally done by setting up a partnership agreement where the financial rights of each partner are set out. Just as with sole traders, the partners will withdraw part of the profits that are due to them in the form of drawings from the business although, in some cases, partners may also be paid a salary by the business.

After reading this case study, answer the following questions

1. A partnership is a group of individuals who are ………… together with the intention of making profit.

   a) Business
   b) Arrangements
   c) Involves
   d) Trading

2. What are the most types of for- profit partnership?

3. What are the advantages and disadvantages of partnership?

3.1.1. Meaning of partnership business

Partnership may be defined as: a relation between persons carrying on a business in common with a view of profit. A partnership is owned by two or more people but not more than twenty persons except in certain cases. In most forms of partnerships, each partner has unlimited liability for the debts incurred by the business. The three most prevalent types of for-profit partnerships are:

- General partnerships
- Limited liabilities partnerships
- Limited partnerships. E.g: practicing solicitors, professional accountants and members of the stock exchange where this figure may be exceeded.

Types of partners:

1. **According to participation in the running of the business**

   a) **Active partner:** This actively participates in the day to day running of the business.

   b) **Dormant/sleeping partner:** Does not actively participate in the day to day running of the business

2. **According to age**

   a) **Major partner:** This is a partner who is above the maturity age

   b) **Minor partner:** This partner has not attained maturity age and therefore has limited liability.

3. **According to liability**

   a) **Limited partner:** This partner has limited liability. This means that his/her liability towards the debts of the partnership is limited to his/her capital contributions. Minor partners have limited liability.

   b) **Unlimited partner:** This partner is liable for all the debts of the partnership to the extent of selling personal property to pay the debts of the partnership.

4. **According to capital contributions**

   a) **Quasi partner:** This does not contribute capital, but allows his/her name to be used by the partnership.

   b) **General partner:** This is a partner because of capital contributions.

Advantages and disadvantages of partnerships

Advantages of partnership:

- More capital is raised from bigger membership
- Better skills from a variety of members
- Better decisions can be made compared to sole proprietors
- Partnerships are easy to form compared to limited companies
- Risks are minimal as they are spread across many members.
- Partnerships can easily access credit from financial institutions since lenders find it easier to deal with a group of people than one individual

Disadvantages of partnerships:

- Profits are reduced as they are shared among many members
- Partners have unlimited liability_ they have equal sharing when it comes to the liabilities of a partnership
- Delays in decision making compared to sole proprietors
- They are not permanent in nature because the death or retirement of a partner may lead to its dissolution

Business usually depends on active partners and is likely to be affected in case they die

Application activity 3.1

Read carefully and discuss on the following questions:

a) What are the components of a partnership deed?

b) What happens if no partnership deed exists?

c) State and explain the types of goodwill.

3.1.2. Partnership agreement or deed

This is a written agreement among partners regarding the terms and conditions of the partnership business.

Components of partnership agreement or deed

A partnership deed usually contains the following;

- Capital to be contributed by each member.
- Names of partners

- Profit and loss sharing ratios
- Salaries paid to partners
- Partners drawing rights and interest on drawings
- Preparation and auditing of books of accounts
- Duties, powers and liabilities of each member.
- Basis of valuation of good will
- Methods of dealing with the death, retirement and insolvency of partners
- Methods of admission of a new partner
- Method of settling the accounts in case of dissolution.

If no partnership deed that exists

- Profits and losses are shared equally
- There will be no interest on capital
- There will be no interest on drawings
- No payment of salaries to partners
- If a partner gives a loan to the partnership business, he is entitled to 5% interest per annum.

Accounting for goodwill in partnership accounts

Goodwill is an intangible asset arising from the business's ability to earn more profits as compared to other firms in the same or similar trade. Goodwill arises when the value of the business as a going concern is greater than the value of its separate tangible assets. It is the excess of purchase consideration of a business sold as a going concern above the fair market value of the business assets.

Goodwill arises in the business because of the following reasons,

- The business may have enjoyed some form of monopoly either nationally or locally for example there may not be sufficient trade to out compete some Engineering firms, which have been managed or run for a long period.
- A new business may continue to trade under the same name as that of the original firm. The fact that the firm was well known could mean that new customers and old customers are attracted for this reason.
- The value of labor force including management skills other than that of the retiring proprietor may be carried forward. Skilled management is an asset to the business.
- The possession of patent rights and trademarks may account for goodwill. These may have cost the original owner little or nothing

and they could be shown in the balance sheet. They are normally unsellable, unless the business is sold as a going concern.

- The location for the Business premises may be more valuable if the business does not change. Where the business is strategically located this is an advantage.
- The cost of research and development, which might have brought about cheaper manufacturing methods or cheaper products, may be charged to the current buyer. The amount that the buyer is prepared to pay will depend on his view of the future profits which will accrue to the factors mentioned above.

Types of goodwill:

In accounting, goodwill is classified into inherent goodwill, purchased goodwill and negative goodwill.

1. **Purchased goodwill** arises from a defined financial transaction and hence its recorded in the financial statement like any other assets in accordance with international financial reporting standard 3 IFRS3-BUSINESS COMBINATION.IFRS3 Provides for immediate write-off of goodwill after acquisition or amortization for a period not exceeding twenty years using straight-line method.
2. **Inherent goodwill** on the other hand arises out of normal carrying out of the business activities. It is never recorded in the books because recording it would mean anticipating gains that would only be realized on the sale of the business that may never happen.
3. **Negative good**will arises when the realizable value of the business sold as a going concern is exceeded by the fair market value realized from individual assets.

Circumstances that lead to ascertainment of good will

When dealing with partnership accounts, goodwill may be recognized under the following circumstances:

-Admission of a new partner into the established partnership especially when the old partners have built goodwill into the business. This is to enable the new partner to compensate for the share of the good will he/she is going to enjoy.

- On death or retirement of one partner from an established partnership.

- At dissolution of the partnership.
- When there is a change in the mode of ascertaining profit and loss of the firm.
- When there is a change in the profit sharing ratios.

3.2. Introduction to partnership accounts

Learning Activity 3.2

On 01.01.2020. Kefa and Sifa started a partnership business which is located in HUYE district. They agreed to contribute equally and their capital contribution amounted to 250,000 RWF. Upon their agreement Kefa and Sifa injected in addition capital of 20,000 RWF. On 31.3.2020, they shared interest on the capital on the profit made. On 5.3.2020, they withdrew money for personal use. On 30.5.2020, they paid interest on drawings. A salary was also paid to Sifa. After paying all the expense profit was shared by the partners by using their sharing ratios. After two years their business made a loss.

Required:

After understanding this scenario, as an accountant who completed in S4 Accounting,

What are the necessary accounting entries for this partnership?

3.2.1. Meaning of accounting entry

An accounting entry is a formal record that documents transaction. In most cases, an accounting entry is made using the double entry bookkeeping system, which requires one to make both a debit and credit entry, and which eventually leads to the creation of a complete set of financial statements. An accounting entry can also be made in a single entry accounting system; this system typically tracks only cash receipts and cash disbursements and shows only those results needed to construct an income statement.

Types of accounting entries:

They are three primary types of accounting entries, which are noted below

1. Transaction entry

A transaction entry is the primary type of business event for which the accountant would create an accounting entry. Examples of accounting transactions are the record of an invoice to a Customer, an invoice from a supplier, the receipt of cash and the purchase of a fixed asset. This type of accounting entry is used under both the accrual basis and cash basis of accounting.

2. Adjusting entry

An adjusting entry is a journal entry used at the end of an accounting period to adjust the balances in various general ledger accounts to more closely align the reported results and financial position of a business to meet the requirements of an accounting framework, such as **GAAP** or **IFRS.** This type of accounting entry is used under the accrual basis of accounting

3. Closing entry

A closing entry is a journal entry used at the end of an accounting period to shift the ending balances in all revenue, expense, gain, and loss accounts (known as temporary accounts) into the retained earnings account. Doing so empties out the temporary accounts, so that they can begin accumulating transactional information in the next accounting period.

How to create accounting entries?

Accounting entries for transactions are typically created through a transaction interface in the accounting software, so that you may not even realize that you are creating an accounting entry (such as, for example: when creating a customer invoice). If you are creating an adjusting accounting entry, then you will use a journal entry format (assuming that a double entry accounting system is being used). If you are closing the books at the end of an accounting period, the accounting software will likely create the closing entry automatically; you will not even see the entry.

Accounting entries

1. In case of additional capital contributed.

Dr. cash/bank/asset a/c

Cr. Individual partner capital a/c

2. In case of interest on capital

Dr. Interest on capital a/c

Cr. Individual partner`s current a/c

3. In case of any drawings

Dr. Individual partner's current a/c

Cr. Cash/bank/asset a/c

4. In case of any interest on drawings

Dr. individual partner`s current a/c

Cr. Interest on drawings

5. Salaries paid to a partner

Dr. salaries a/c

Cr. Individual partner`s current a/c

6. Share of profits by a partner

Dr. income statement a/c

Cr. Individual partner current a/c

7. Share of loss by a partner

Dr. Individual partner current a/c

Cr. Income statement a/c

3.3. Components of Partnership Final accounts

Learning Activity 3.3

On 01.01.2010, Ineza, Louise and Gisa started a partnership firm in Nyagatare District, buying and selling cars. After 1 year, they needed to ascertain if they got a profit or loss.

1. Which document can help them to know if they made a profit or loss?

3.3.1. Income statement of partnerships

The trading on profit and loss of a partnership is the same as that of a sole trader only that it has an extension called the appropriation account.

Format of the income statement of partnerships

Sales		Xxx
Less: cost of sales		
Opening inventory (stock)	x xx	
Add: purchases	x xx	
Less: closing inventory	x xx	
Cost of sales		Xxx
Gross profit		Xxx
Add: other incomes		Xxx
Gross income		Xxx
Less: operating expenses		Xxx
Profit for the year		Xxx

NB:

- Interest on a loan is a business expense and treated as a business expense and treated in the profit and loss a/c
- If a partnership gives out a loan in return for interest, the interest received is treated as an income.
- If a partner gives a loan to a partnership, interest charges on the loan is a business expense and charged against the profit and loss a/c.

Illustration1:

The following trial balance was extracted from the books of Nema, keza and Manzi at 31 December 1990 (trading account has already been prepared)

	RWF	RWF
Capital accounts: Nema		60,000
Keza		40,000
Manzi		20,000
Current a/c at 1Jan.,1990:Nema		2,000
Keza		3,000
Manzi	1,000	

	RWF	RWF
Drawings for year: Nema	12,000	
Keza	8,000	
Manzi	10,000	
Gross profit for the year		70,000
Expenses	42,500	
Fixed assets	110,000	
Current assets	48,750	
Current liabilities		37,250
	232,250	

Required: The preparation of a profit and Loss account for the year ended 31 December1990

Addition information:

- Interest is to be allowed at 6% per annum on partners 'capital accounts.
- RWF 5,000 is to be allowed as a salary to Manzi

Answer:

Nema, Keza Manzi

P&L a/c for the year ended 31 December 1990

	RWF		RWF
Expenses	42,000	Gross Profit b/d	70,000
Net profit c/d	27,500		
	70,000		70,000

Illustration 2

Martin and Melvin are in a partnership sharing profits and losses equally. The following is their trial balance as at 30.06.2010

	RWF	RWF
Buildings (cost 75000)	50,000	
Fixtures at cost	11,000	
Provision for depreciation on fixtures		3,300
Debtors and creditors	16,243	11,150
Cash at bank	677	
Stock 1.7.2009	41,979	
Sales		123,650
Purchases	85,416	
Carriage outwards	1,288	
Discounts allowed	115	
Loan interest: Benson	4,000	
Office expenses	2,416	
Salaries and wages	18,917	
Bad debts	503	
Provision for bad debts		400
Loan from Benson		40,000
Capitals: Martin		35,000
Melvin		29,500
Current accounts: Martin		1,306
Melvin		298
	244,604	244,604

Required: Prepare profit and loss account for the year ended 30.06.2010

a) Stock 30.06.2010 was 56,340

b) Expenses to be accrued; office expenses 96, wages 200

c) Depreciate fixtures 10% on reducing balance basis, buildings 1,000

d) Reduce provision for bad debts to 320

e) Partnership salary 800 to Martin not yet paid.

f) Interest on drawings: Martin 180

Melvin 120

g) Interest on capital account at 10%.

Solution

Martin and Melvin

Income statement for the year ended 31.12.2010

	RWF	RWF
Sales		123,650
Less: cost of sales		
Opening stock	41,979	
Add: purchases	85,416	
	127,395	
Less: closing stock	56,340	71,055
Gross profit		52,595
Add: decrease in provision for bad debts		80
Gross income		52,675
Less: Expenses		
Salaries and wages (18,917 + 200)	19,117	
Office expenses (2,416 + 96)	2,512	
Carriage outwards	1,288	
Discounts allowed	115	
Bad debts	503	
Loan interest	4,000	
Depreciation: Fixtures 770		
Buildings 1,000	1,770	29,305
Net profit		23,370

Partnership appropriation account

The appropriation account is prepared after preparing Profit & Loss A/C. In the case of partnership firms, it is prepared to show how profits are distributed among the partners involved in the partnership.

In the case of LLC (Limited Liability Company), the purpose of preparing this account is the same but the format is different. We will start with the year's profit before the taxation figure, from which we will subtract corporate taxes and dividends to find the retained earnings for the year.

In the government's case, the appropriation account is used to show the funds allocated to the specific project. Any expenses are reduced from the funds allocated.

The following are the adjustment/items included in this account:

1. **Net Profit:** It is the opening balance of appropriation a/c. This balance is taken from Profit & Loss a/c after making all the necessary adjustments for the period.
2. **Interest on Capital:** The expense for the company as a partner will be paid interest on the amount of capital invested in the business.
3. **Interest on Drawings:** It is an income for the company. The company will charge interest from the partner on any amount of capital withdrawn during the year.
4. **Partner's Salary:** It is pre-agreed as per the partnership deed and is an expense for the business.
5. **Partner's Commission:** It is pre-agreed as per the partnership deed and is an expense for the business.
6. **Net Profit transferred to Partner's Account**: After making all the above adjustments, this is the final profit amount.

Format of profit and loss appropriation (P&L)

P&L appropriation a/c for the year ended 31/12/xxx

Particulars	Debit amount	Particulars	Credit amount
Transfer to reserves	xxx	Net Profit	Xxx
Interest on Capital		Interest on drawings	
-partner A	xxx	Partner A	Xxx
-Partner B	xxx	Partner B	Xxx
Salary to partner			
-partner A	xxx		
-Partner B	xxx		
Commission to partner	xxx		
Net profit transferred to partner's account			
Partner A	xxx		

Partner B	xxx		
Total		Total	

Illustration1:

Profit & Loss (P&L) Appropriation A/c

A & B started a partnership firm on 01.01.2017. They contributed RWF 50,000 each as their capital. The terms of a partnership are as under:

- A& B to get monthly salary of RWF 1,000 & RWF 1,500 respectively
- B is allowed a commission at the rate of 5% of Net profit
- Interest on capital & drawings will be 10% p.a.
- Sharing of profit & Loss will be in the ratio of capital sharing.

Before making the above appropriations, the profit for the year ending 31.12.2017 is RWF 75,000. Drawings of A & B were RWF 10,000 & RWF 20,000 respectively. Prepare Profit & Loss Appropriation Account.

Solution

Working

WN 1 Interest on Capital @10% of the Capital Invested

Partner A = 50000*10% = 5000

Partner B = 50000*10% = 5000

WN2 Commission @5% of Net Profits

Partner B = 75000*5% = 3750

WN3 Interest on Drawings @ 10% of Amount of Drawings

Partner A = 10000*10% = 1000

Partner B = 20000*10% = 2000

WN4 Net Profit divided among partners in ratio of their capital i.e 50% each

Partner A = (78000-(5000+5000+12000+18000+3750))/2 =17125

Partner B = (78000-(5000+5000+12000+18000+3750))/2 =17125

P&L Appropriation A/C for the year ended 31/12/2017

Particulars	Debit amount(RWF)	Particulars	Credit amount(RWF)
Transfer to reserves		Net Profit	**75,000**
Interest on capital(WN1)		Interest on drawings(WN3)	
Partner A	**5,000**	Partner A	**1,000**
Partner B	**5,000**	Partner B	**2,000**
Salary to partner			
Partner A	**12,000**		
Partner B	**18,000**		
Commission to partner B(WN2)	3,750		
Net Profit transferred to partner's account(WN4)			
Partner A	17,125		
Partner B	17,125		
Total	**78,000**	**Total**	**78,000**

Illustration 2:

Hirwa and Manzi started business in partnership on 1st January, 2015 without any agreement. Mr. Hirwa introduced capital RWF. 60,000 and Mr. Manzi RWF 40,000. On March 1st, 2015Mr. Manzi advanced RWF 20,000 by way of loan at an interest rate of 6% per annum. The profit for the year ended 31st, December 2015, was amounted to RWF 18,000.

Required: Prepare Profit and Loss Appropriation Account at the end of 2015.

Solution:

Hirwa and Manzi P&L Appropriation A/C for the period ended 31st December, 2015

Description	Amount (RWF)	Description	Amount (RWF)
Interest on loan(20,000*6%*10/12)	**1,000**	Net Profit b/d	**18,000**
Profit distribution			
Hirwa (17,000/2)	**8,500**		
Manzi (17,000/2)	**8,500**		
Total	**18,000**	**Total**	**18,000**

Illustration 3

Tony, Feza and Sifa are in partnership with capital of RWF 200,000; 80,000 and RWF 20,000 respectively. Their partnership deed provides for the following:

i. Interest on capital at 4% per annum

ii. Interest chargeable on drawings at 5% per annum

iii. Tony and Feza to receive salaries of RWF20,000 each per annum

iv. Tony, Feza and Sifa are to share the profits and losses in the ratio 6:3:1 respectively.

The following information is available for the year ended 30 June 2000:

Current account balances:	RWF'000'
Tony	8,400 Cr
Feza	3,600 Dr
Sifa	2,300 Cr
During the year, quarterly drawings were	
Tony	2,400
Feza	1,800
Sifa	1,800
Net Profit for the year ended 30 June 2000	105,000

Required:

The appropriation account for the year ended 30 June 2000

Solution

Tony, Feza and Sifa

The appropriation account for the year ended 30 June 2000

Particulars	RWF	RWF	RWF
Net profit for the year			10,000
Interest on drawings:			
Tony		120	
Feza		90	
Sifa		90	300
Less: interest on capital			
Tony	8,000		
Feza	3,200		
Sifa	800	12,000	
Salaries: Tony	20,000		
Feza	20,000	40,000	52,000
			53,300
Balance of profits to be shared:			
Tony 6/10		31,980	
Feza 3/10		15,990	
Sifa 1/10		15,990	
		5,330	53,300

Working:

W-1. Interest on drawing, 5% per annum

Tony: drawing 2,400; Interest: 2,400*5/100=120

Feza: drawing 1,800; Interest: 1,800*5/100=90

Sifa: drawing 1, 800; Interest: 1,800*5/100=90

W-2. Interest on capital 4% per annum

Tony: capital 200,000; Interest: 200,000*4%=8,000

Feza: capital 80,000; Interest: 80,000*4%=3,200

Sifa: capital 20,000; Interest: 20,000*4%=800

W-3. Balance of profit to be shared

Total profits=RWF 53,300

Tony, Feza, and Sifa =6:3:1

Tony: 53,300*6/100=3,198

Feza: 53,300*3/100=1,599

Sifa: 53,300*1/100=533

Importance of Appropriation Account

This account shows the number of profits divided among various heads.

It shows the number of profits transferred to reserves and distributed as dividends.

It gives information on how the profits are divided among partners and how the various adjustments are made during the year.

Conclusion

Hence, the appropriation account shows how the profits are appropriated or distributed among various heads. This account is prepared on behalf of the firm.

3.3.2. Partnership capital accounts

Definition:

A partnership capital account is an account that contains all the transactions occurring between the partners and the partnership firm, such as the initial contribution of capital in partnership, the interest of capital paid, drawings, the share of profit, and others adjustments. It is required to maintain proper accountability and transparency between the partners and the firm.

Fixed capital accounts, Current accounts, Fluctuating capital accounts:

When fixed capital accounts are maintained, the capital account records the partner's capital contribution only.

A current account is opened up where partner's dealings with the partnership are recorded e.g. interest on capital, interest on drawings, partner's salaries etc.

Under fluctuating capital balance method, the capital account records the capital contributions and other partners' dealings with the partnership e.g. salaries, interest on capital, drawings, interest on drawings, share of profits etc.

Fixed capitals are more preferable than fluctuating capitals. With current accounts where a partner is drawing more than his share of profit, the partner's current account will show a debit balance and this is a warning that his drawings are excessive.

Note: Fluctuating capital accounts is a combination of Fixed capital accounts **and** Current accounts

Fixed capital balance method

Capital account

Details	A	B	Details	A	B
Bal c/d	Xxx	Xxx	Bal b/d	xxx	xxx
			Additional capital	xxx	xxx
	Xxx	Xxx		xxx	xxx

Current account

Details	A	B	Details	A	B
Drawings	Xxx	Xxx	Bal b/d	xxx	xxx
Interest on drawings	xxx	xxx	Interest on capital	xxx	xxx
Bal c/d	xxx	xxx	Salaries	xxx	xxx
			Share of profits	xxx	xxx
	Xxx	Xxx		xxx	xxx

Fluctuating capital balance method

Capital accounts

Details	A	B	Details	A	B
Drawings	Xxx	Xxx	Bal b/d	xxx	Xxx
			Additional capital	xxx	xxx
Interest on drawings	xxx	xxx	Interest on capital	xxx	xxx
			Share of profits	xxx	xxx
Bal c/d	xxx	Xxx	Revaluation profits	xxx	xxx
	Xxx	Xxx		xxx	xxx

Illustration 1

Charles and Robert are in partnership sharing profits and losses in a ratio 3:2 respectively. They are entitled to 5% per annum interest on capitals. Their capitals are; Charles 20,000 and Robert 60,000.

Robert is to have a salary of 5,000.

They charge interest on drawings Charles being 500 and Robert 1,000.

During the year drawings for Charles and Robert were 20,000 each.

Their share of profits is 25,500 and 17,000.

Required: Show the partners' capital accounts.

Fixed capital accounts

Details	Charles	Robert	Details	Charles	Robert
			Bal b/d	20,000	60,000
Bal c/d	20,000	60,000			
	20,000	60,000		20,000	60,000

Current accounts

Details	Charles	Robert	Details	Charles	Robert
Drawings	20,000	20,000	Interest on capital	1,000	3,000
Interest on drawings	500	1,000	Salary	-	5,000
			Share of profits	25,500	17,000
Bal c/d	6,000	4,000			
	26,500	25,000		26,500	25,000

Fluctuating capital accounts

Details	Charles	Robert	Details	Charles	Robert
Drawings	20,000	20,000	Bal b/d	20,000	60,000
Interest on drawings	500	1,000	Interest on capital	1,000	3,000
			salary	-	5,000
Bal c/f	26,000	64,000	Share of profits	25,500	17,000
	46,500	85,000		46,500	85,000

Illustration2

ABC and Co. are a partnership firm with the three partners, A, B, and C. Profit sharing ratio of each partner is equal, and the capital contribution of each partner is also equal. The total requirement of investment in the business is FWR 300,000. The firm does not maintain a separate current account and all the transactions are to be recorded in the capital account itself. Other details are as under:

Particulars	RWF
Drawings	10,000 p.a per Partner
Total profit at the end before interest on Capital and remuneration of partners	75,000
B and C are entitled to receive salary of RWF 10,000 p.a.	
Interest on capital to be credited in capital account	12%

Required: Draw the Partners Capital account and record the above transactions.

Solution:

Capital Contribution = RWF 300,000 / 3 = RWF 100,000

Interest on Capital = RWF 100,000 * 12% = RWF 12,000 per partner.

Profit Share =RWF 75,000/3 =RWF 25,000 per partner

Particulars	A	B	C	Particular	A	B	C
Drawings	10,000	10,000	10,000	By cash bank	100,000	100,000	100,000
				By interest on capital	12,000	12,000	12,000
				By salary		10,000	10,000
To balance c/f(closing capital)	127,000	137,000	137,000	By share of profit	25,000	25,000	25,000
Total	137,000	147,000	147,000	Total	137,000	147,000	147,000

3.3.3 Balance sheet (statement of financial position)

Definition:

Balance sheet summarized a company's assets, liabilities and shareholders' equity at a specific point in time (as indicated at the top of the statement). It is one of the fundamental documents that make up a company's financial statements. The balance sheet also reveals the book value of a company's assets, liabilities and shareholder's equity.

Structure of the balance sheet

Non-current assets	Cost	Acc.depn.	NBV
Plant and machinery	Xxx	Xxx	Xxx
Buildings	Xxx	Xxx	Xxx
			Xxx
current assets			
Inventory		Xxx	
accounts receivable		Xxx	
Bank		Xxx	Xxx
Total assets			Xxx
Equity and liabilities			
capital a/c			
A			Xxx
B			Xxx
C			Xxx
Current a/c			
A		Xxx	
B		xxx	
C		(xxx)	Xxx
Non-current liabilities			
Loan			Xxx
Current liabilities			
Accounts payable			Xxx
Total capital and liabilities			Xxx

NB: A positive balance means a credit balance while a negative balance means a debit balance.

We used the same example which is above

Illustration1

Martin and Melvin are in a partnership sharing profits and losses equally. The following is their trial balance as at 30.06.2010

	RWF	RWF
Buildings (cost 75000)	50,000	
Fixtures at cost	11,000	
Provision for depreciation on fixtures		3,300
Debtors and creditors	16,243	11,150
Cash at bank	677	
Stock 1.7.2009	41,979	
Sales		123,650
Purchases	85,416	
Carriage outwards	1,288	
Discounts allowed	115	
Loan interest: Benson	4,000	
Office expenses	2,416	
Salaries and wages	18,917	
Bad debts	503	
Provision for bad debts		400
Loan from Benson		40,000
Capitals: Martin		35,000
Melvin		29,500
Current accounts: Martin		1,306
Melvin		298
	244,604	244,604

Required: Prepare balance sheet for the year ended 30.06.2010

Additional information:

a) Stock 30.06.2010 was 56,340
b) Expenses to be accrued; office expenses 96, wages 200
c) Depreciate fixtures 10% on reducing balance basis, buildings 1,000
d) Reduce provision for bad debts to 320
e) Partnership salary 800 to Martin not yet paid.

f) Interest on drawings: Martin 180

Melvin 120

g) Interest on capital account at 10%.

Solution:

Balance sheet as at 30.06.2010

Fixed assets	**Cost**	**acc.depn.**	**NBV**
Buildings	75,000	26,000	49,000
Fixtures	11,000	4,070	6,930
	86,000	30,070	55,930
Current assets			
Stock		56,340	
Debtors			
Less: provision for bad debts	320	15,923	
Bank		677	72,940
_Total assets			128,870
Equity and liabilities			
Capitals: Martin		35,000	
Melvin		29,500	64,500
Current accounts			
Martin		7,236	
Melvin		5,688	12,924
			77,424
Non-current liabilities			
Loan from Benson			40,000
Current liabilities			
Creditors		11,150	
Expenses owing		296	11,446
Total equity and liabilities			128,870

Changes in ownership of partnership

These include:

- Admission of a partner
- Death of a partner
- Dissolution

i. Admission of a partner

A new partner(s) can be introduced after all partners are in agreement to this effect. The old partnership ceases to exist and a new partnership starts. The accounts of the old partnership can be closed then a new set of accounts prepared for the new partnership. This is really followed. So admission of a partner merely entails addition of a capital column for the new partner and the following entries thereafter:

Dr Asset accounts

Cr Capital account (with assets received from the joining partner which can be cash)

However, both admission and retirement/death bring about the following additional issues:

Goodwill will be recorded during any change in ownership as follows:

Dr Goodwill account

Cr Capital accounts (in old profit sharing ratio)

This can remain in the accounts like this or it can be eliminated. If it remains in the accounts, then the partners' capital would have increased.

Goodwill can be eliminated as soon as transition in ownership is complete by:

Dr Capital accounts (in new profit sharing ratio)

Cr Goodwill

This is of course, subject to continuance of the business. Goodwill will not be eliminated if there is no business continuance like in dissolution.

This process ensures that the joining partner pays for the goodwill that had already existed. This is because the new profit share ratio will include the new partner.

Revaluation account

Revaluation of assets and liabilities are usually carried out during changes in ownership. In such cases account will be opened.

After opening the revaluation account is just to find increase or decrease due to revaluation, which is dealt with in the following way.

Dr Revaluation account Cr Assets accounts Decrease of the assets amounts that have been revalued	X	X
Dr Liabilities accounts	X	
Cr Revaluation account		X
Decrease of the liabilities amounts that have been revalued		
Dr Assets account	X	
Cr Revaluation accounts		X
Increase in assets amounts that have been revalued		
Dr Revaluation accounts	X	
Cr Liabilities account		X
Increase in liabilities amounts that have been revalued		
If a credit balance remains the this is a profit on revaluation		
Dr Revaluation account	X	
Cr Current accounts		X
Profit from revaluation (using the old profit sharing ratios)		
If a debit balance remains the this is a loss on revaluation		
Dr Current accounts	X	
Cr Revaluation account		X

Loss from revaluation (using the old profit sharing ratios)

If there any changes in between the year then the profit or loss up to this date has to be shared to the old partners. After the changes the profit/loss earned or incurred is shared to the new partnership in the new structure. Sometimes the expenses can be divided between the periods to be able to determine the profit that period.

Application activity 3.3

Nziza and Mwiza are in partnership sharing profits and losses equally. The following is their balance as at 30 June 2001

Particulars	RWF'000' Dr	RWF'000' Cr
Capital: Nziza		350,000
Mwiza		295,000
Current a/c: Nziza		13,060
Mwiza		2,980
Drawings: Nziza	64,000	
Mwiza	56,500	
Buildings (cost RWF 900,000)	650,000	
Fixtures at cost	110,000	
Provision for depreciation(fixtures)		33,000
Debtors	162,430	
Creditors		261,500
Cash at bank	6770	
Sales		1,236,500
Stock at (30 June 2000)	419,000	
Purchases	854,000	
Carriage Outwards	12,880	
Discounts allowed	1,150	
Loan interest: bank	40,000	
Office expenses	24,160	
Salaries and wages	189,170	

Particulars	RWF'000' Dr	RWF'000' Cr
Bad Debts	5,030	
Loan from bank		400,000
Provision for bad debts		4,000
	2,596,040	2,596,040

Additional information:

i. Stock, 30 June, RWF 650,000

ii. Expenses to be accrued: Office expenses RWF 800, wages RWF1,500

iii. Depreciate fixtures 10 per cent on reducing balance basis, building RWF 12,000

iv. Reduce provision for bad debts to RWF 3,200

v. Partnership salary: RWF1,500 to Nziza

vi. Interest on drawings: Nziza RWF 1,500; Mwiza RWF 1,100

vii. Interest on capital account balances at 10 per cent.

Required:

Prepare a trading and Profit and Loss appropriation account for the year ended 30 June 2001, and a balance sheet as at that date.

End unit assessment 3

1. What do you understand about:
   - Fixed capital accounts
   - Current accounts
   - Fluctuating capital accounts
2. Where partners do not prepare an agreement.
3. Okello, Opio and Ouma are in partnership. At the end of the first year they had the following details; on 31/12/2006.

Current accounts:	**RWF'000'**
-Okello	20,000
-Opio	60,000
-Ouma	40,000
Gross profit	980,000
Salaries and wages	38,000
Rent and Rates	150,000
Electricity	80,000
Interest received	20,000
Stationery	64,000
Buildings	200,000
Motor van	300,000
Drawings:	
Okello	200,000
Opio	150,000
Ouma	120,000
Loan to the firm(Opio)	2,000,000

Additional information

i. Depreciate all fixed assets at a rate of 10% p.a

ii. There was no partnership agreement.

Required:

a) Prepare a profit and Loss Appropriation account

b) Prepare partners current accounts

3. 3. The following list of balances as at 30 September 2009 has been extracted from the books of Brick and Stone, trading partnership, sharing the balance of profits and losses in the proportions 3:2 respectively.

	RWF
Printing, stationary and postage	
Sales	3,500
Inventory in hand at 1 October 2008	322,000
Purchases	23,000
Rent and Rates	208,200
Staff salaries	10,300
Telephone charges	36,100
Motor vehicles running costs	2,900
Discount allowable	5,620
Discount receivable	950
Sales returns	370
Purchases returns	2,100
Carriage inwards	6,100
Carriage outwards	1,700
Fixtures and Fittings: at cost	2,400
Accumulated for depreciation	26,000
Motor vehicles: at cost	11,200
Accumulated for depreciation	46,000
Allowance for doubtful debts	25,000
Drawings:	300
Brick	
Stone	24,000
Current account balances at 1 October 2008	11,000

	RWF
Brick	
Stone	3,600
Capital account balance at 1 October 2008	2,400
Brick	
Stone	33,000
Receivables	17,000
Payables	9,300
Balance at bank	8,400
	7,700

Additional information

i. RWF 10,000 is to be transferred from Brick's capital account to a newly opened Brick Loan

Account on 1 July 2009, interest at 10 per cent p.an on the loan is to be credited to Brick

ii. Stone is to be credited with a salary at the rate of RWF12,000 per annum from 1 April 2009.

iii. Inventory at 30 September 2009 has been valued at cost at RWF32,000.

iv. Telephone charges accrued due at 30 September 2009 amounted to RWF400 and rent of RWF600 prepaid at that date.

v. During the year ended 30 September 2009 Stone has taken goods costing RWF1,000 for his own use.

vi. Depreciation is to be provided at the following annual rates on the straight line basis: Fixtures and fittings 10% Motor vehicles 20%

Required:

a) Income statement and appropriation account for the year ended 30 September 2009.

b) Prepare a Statement of financial position as at 30 September 2009, which should include summaries of the partners' capital and current accounts for the year ended on that date

Unit 4 INTRODUCTION TO NON-PROFIT ORGANIZATIONS

Key unit competence: To be able to prepare financial statements for non-profit organizations

Introductory activity

Schools, hospital, clubs, Charitable Organizations, NGOs etc share common features as they do not operate like trading organizations. Their objectives are rather limited to various social and charitable features. Thus the nature of their accounting records must reflect the nature of their operating activities and take form of there

What do you think can be the accounts that are done by non-profit making organizations?

4.1. Introduction to non-profit organizations

Learning Activity 4.1

Non-profit making organizations record and report their transactions in form of accounts same as profit making organizations.

Required: What do you think is the difference between the two?

The topic of accounting for nonprofit organizations (NPOs), differs from commercial accounting in many respects. NPOs' main goal is to serve the public rather than to make money for their collaborators or owners. Nonprofit organizations (NPOs) are money oriented, whereas commercial organizations are profit focused, because their expenses must be met by revenues, which are financed by grants or contributions rather than market transactions.

These organizations whose establishment is mainly non-profit making are namely ; Schools, hospital, clubs, Charitable Organizations, NGOs etc.

These organizations provide specific services to the community without profit drive. Although these organization charge fees to the services provided to the beneficiaries, its low compared to the benefit.

Non-profits organizations prepare final accounts like profit making organizations but they differ in the following circumstances :

- A cash book is replaced by receipts and payments A/C
- Profit and loss A/c is replaced by income and expenditure A/C
- Capital is replaced by accumulated funds
- Net profit is called excess of income over expenditure
- Net loss is called excess of expenditure

Differences between Profit making and Non-profit making organizations

Profit making Organizations	Non-profit making Organizations
1. The main purpose is making profits 2. It uses cashbook 3. Prepares a profit and loss account 4. Their initial balance in the balance sheet is called capital 5. The difference between profit and loss is a net profit /net loss 6. Net profit is added to capital while net loss is deducted from capital in the balance sheet. 7. Capital is contributed by members	1. They are set up to provide social services but making profits is not their motive 2. It uses receipts and payments A/c 3. Uses an income and expenditure A/c 4. The initial balance in the balance sheet is the accumulated fund 5. The difference in income and expenditure account is a Surplus or a deficit. 6. Surplus is added to the accumulated fund while the deficit is deducted from accumulated fund in the balance sheet 7. They seek donations from partners, corporations or foundations.

Receipts and payments Account of non-government organizations

This is a summary of all cash and Bank transactions that took place during a particular accounting period and these include ;

- Opening balance
- The receipts for the period
- The payment for the period
- Closing balance

Illustration

Receipts and Payments Account

Balance b/d Cash	xxx	Salary	xxx
Bank	xxx	Wages	xxx
Donations	xxx	Rent	xxx
Grant	xxx	Printing and stationery	xxx
Capital Development	xxx	Advertizing	xxx
Sale of tickets	xxx	Transport	xxx
Subscriptions	xxx	Repairs	xxx
Gate collection	xxx	Balance c/d Cash	xxx
	xxx	Bank	xxx
Balance b/d Cash	xxx	Balance c/d	xxx
Bank	xxx		xxx

NOTE : Receipts and payments account is simply a summarized cash account

Incomes and expenditure Account

As contrast to profit making organizations, profit generated from non-profit making organizations is termed as excess of income over expenditure same as for the loss.

Income and expenditure account is presented in same manner as the profit and loss account for profit making organization in such way that costs incurred are compared to the revenues or incomes.

The main features of income and expenditure account ;

- It is a summary of all items relating to income and expenditure on accrual basis
- It deals with only revenue and expenditure items
- Income is credited while expenditure is debited
- Account balance is represents a surplus or deficit for the period and is transferred to the accumulated funds.
- The main sources of income are subscriptions, incomes from social activities like dance parties, film, plays, donations etc.

NOTE : Sometimes Bar account is prepared separately like a trading account. Mostly is prepared within the income and expenditure account.

Illustration

Income and Expenditure Account

Refreshments	xxx	Profit from bar	xxx
Repairs &Rent	xxx	Donations	xxx
Insurance	xxx	Subscriptions	xxx
Rates	xxx	Membership fees	xxx
Printing & Postage	xxx	Gate collections	xxx
Wages	xxx	Competition fees	xxx
Depreciation	xxx		
Office expenses	xxx		xxx
Advertizing	xxx		xxx
Electricity	xxx		
Surplus c/d	xxx		
	Xxx		

Bar trading Account

The club may occasionally establish a bar to serve drinks to its participants when they meet. In this case the bar is set for the purpose of earning additional income to the club. The account for the bar will be prepared in the same way as of profit making business and the profit will be transferred to the income and the expenditure account as an income.

Bar trading Account

Opening Stock	xxx	**Bar sales**	**xxx**
Add: Bar purchases	xxx		
Add: Bar wages	xxx		
Less: Bar stock	xxx		
	xxx		
Costofgoods sold	xxx		**xxx**
Barprofits c/d	xxx		**xxx**
	Xxx		

Surplus and Deficit

A surplus is the excess of income over expenditure that is, when (incomes exceed the expenditures). It is arrived at from the income and expenditure account. At the end of every financial period the surplus is added to the accumulated funds in the balance sheet.

When the expenditure exceeds the income the difference is a deficit. A deficit appears as reduction from accumulated funds in the balance sheet.

Accumulated fund

The capital account of a non-profit organization is termed as accumulated fund. Any surplus from the income and expenditure account is transferred to this account and vice versa.

Balance sheet

The term balance sheet refers to a financial statement that reports a company's assets, liabilities, and shareholder equity at a specific point in time.

Non-profit making organizations prepare balance sheet like Profit making organization and their items are treated the same except that for capital in trading organizations. Non-profit making organization's balance sheet is called accumulated fund.

Balance sheet

Accumulated	xxx	**Fixed assets**	
Add: Surplus	xxx	– Land	xxx
Current liability		– Machinery	xxx
Creditors for bar supplies	xxx	Current assets	
Bar supplies	xxx	– Bar stock	xxx
		– Cash	xxx
	Xxx	– Bank	xxx

In non-profit making organizations Accumulated fund= Assets

i.e Assets- liabilities=Accumulated fund,

Thus, accumulated fund + liabilities=Assets

Types of revenues

Business receipts are inflow of economic resources mostly in the form of cash and cash equivalents.

There are mainly two types of revenues notably ;

- Capital receipts
- Revenue receipts

Capital receipts

Capital receipts are commercial receipts that are unrelated to a company's ongoing business operations. They are infrequent yet are advantageous in the long run.

In any business capital is introduced for the smooth running of the business. When realize, capital receipts are often disclosed in the business's balance sheet. This is the money that is paid by the sole trader, partners or members of the company known as shareholders, loans, proceeds from the sale of fixed assets etc. Similarly, non-profit making organizations receive capital in form of membership fees, subscriptions, grants, donations etc.

Example 1.

Suppose, in annual general meeting of Barnabas and sons ltd company, the issue of right shares was approved at the rate of RWF.1000 per share. Barnabas and sons ltd allocated shares to all the existing members of the company proportionately and in return received cash. The cash received by Barnabas

and sons ltd company was a capital receipt.

Revenue receipts

The money that a business makes from its regular business operations is known as revenue receipts. These are recurring in nature and have a direct impact on the company's earnings and loss. Consequently, it is necessary to disclose revenue receipts in the company's or organization's income statement.

These include ;

- Revenue received from sale of goods to customers.
- Revenue received from provision of services to clients
- Income received as interest on a saving account.
- Dividend income received from shares of various companies.
- Rental income received by a company.
- Bad debts recovered by a company
- Cash discount received from vendors.
- Commission income received by a company
- Interest received
- Interest on investment
- Trading profit
- Rental income
- Bad debts recovered, etc

Whereas non-profit making organizations get their receipts from annual subscriptions, cash sales from trading activity of an organization or charges from the use of premises etc.

Example 2.

Suppose ABC ltd Company is in the business of manufacturing and selling clothes in bulk to wholesalers and retailers. ABC ltd invoices its customers on receipt of goods by them and maintains an average collection period of 30 days. ABC records its sale/revenue on receipt of goods by the customers. The sales revenue received by ABC company is a revenue receipt.

Subscription

Subscriptions are made from the members of the organization as major source of non-profit making organizations and these can be ordinary or life subscriptions.

Accounting treatment for subscriptions

- Subscriptions due or arrears are current assets
- Subscriptions received in advance or prepaid are current liabilities
- Subscription taken as income for a particular year should exclude subscriptions received in arrears and subscription received in advance.

Below is the format of subscription account

Balance b/d	xxx	Balance b/d	xxx
(outstanding amounts)		(prepaid amount)	
Income and expenditure A/c	xxx	Receipts and payments	xxx
Balance c/d	xxx		
	xxx	Balance c/d	xxx
Balance b/d	xxx		xxx
		Balance b/d	xxx
		(prepaid)	

Life subscription

In some clubs, members are allowed to become life members by paying life subscription, which allows them to access the club facilities for the rest of their life.

Accounting entries when life subscription is paid ;

Dr Receipts and payment A/c xx

Cr life subscription A/c xx

Instructions must be given regarding how much of the life subscription is to be transferred to the income and expenditure account at the end of the each year.

When transfer is done, the following entries are affected ;

Dr Life subscription A/c xx

Cr income and expenditure A/c xx

The credit balance in the life subscription A/c is long-term liability of the club

Types of expenditure

Expenditure is a payment made using cash or credit to purchase goods or services.

Expenditures are of two that is ;

1. Capital expenditure
2. Revenue expenditure

Capital expenditure is the Cost incurred for the acquisition of fixed assets and their additions. The advantage from this expenditure is divided over multiple periods rather than being entirely utilized in one. It includes fixed assets purchased with the intention of generating income or enhancing the company's ability to generate income. For instance, buying land and buildings and adding things like renovations to buildings, buying plants and machinery, or buying more machinery, etc.

Capital expenditure appears in the balance sheet

Revenue expenditure comprises of expenses paid for during one accounting period that have a fully utilized benefit throughout that period.

Revenue expenditures are just the expenses incurred over a specific time period to operate the firm ; they do not increase the value of fixed assets. It includes things like depreciation, current business expenses, replacements, maintenance, or renewals e.g wages and salaries, rent, rates, carriages etc. Such items appear in Trading and profit and loss accounts for profit making organizations and in an income and expenditure account for non-profit making organizations.

Application activity 4.1

The following information provided is taken from the books of ABC as at 31.12.2022

Subscription received during the year ending 31.12.2022 RWF 1,000,000

Subscription due at the end of 31.12.2022 RWF 100,000

Subscription received in advance for the following year starting on 1.1.2023 RWF 300,000

Required:

Determine the amount of subscription to be taken as income for the year for ABC.

4.2. Accounting for non-profit making organization

Learning Activity 4.2

A new school has been opened in Kagarama Sector due to a number of Students that were moving for a long distance and others could not afford the schools around.

This school has come to carter for the above problems as it receives funding from the government and other donors. It is claimed that much money has been spent on this school.

Required:

In which ways would you expect the ministry of Education to monitor the financial performance of this school?

Nonprofit accounting is the unique process by which nonprofit making organizations plan, record, and report upon their finances. Non-profit organizations focus on accountability and profit making organizations focus on profit making. They adhere to a particular set of guidelines and practices that aid them in maintaining their accountability to their contributions and donors.

Application activity 4.2

Given below are the receipts and payments account ended 31rst December 2021 for Kigali Arena Social Club.

DR			CR
1 Jan balance b/d	800,000	Club disco	100,000
Subscriptions:		Rent	300,000
2021	1,000,000	Ground hire	200,000
2022	200,000	Equipment	1,500,000
Club disco Collections	900,000	Purchaseofrefreshment	700,000
Donations	1,200,00	Balance c/d	2,400,000
Saleofrefreshments	1,100,000		5,200,000
	5,200,000		

Additional information

Stock of refreshment 1/1/2021	RWF 200,000
Stock of refreshment as at 31/12/2021	RWF 300,000
Prepaid rent	RWF 100,000
Ground hire dues	RWF 50,000
Subscription	RWF 300,000

Required

Bar trading account

Prepare an income statement and expenditure account for the year ended 31/12/1021

Balance sheet

End unit assessment 4

1. What are final accounts for non-profit organizations?
    a) Receipts and payment account
    b) Trading and profit and loss account
    c) Income and expenditure account
    d) Both a and c
2. From the following receipts and payments account for Gikoba foot ball club and the additional information is provided. Prepare an income and expenditure account for the year ended 31 December 2021.

Receipts and payments Account

	RWF		RWF
Subscriptions	380,000	Wages	72,000
Donations	80,000	Travelling	64,000
		Printing and stationery	25,000
		Purchase of sports equipments	80,000
		Purchase of new desk	10,000
		Rent	40,000
		Insurance	20,000
		General	32,000
	460,000	Balance c/d	117,000
			460,000

Additional information on 31 December 2021

I. The club consists of 200 members paying annual subscription of RWF 2,000 and only180 members had paid their subscription fully while 10 had paid for 2022.

II. Wages outstanding amounted to RWF 8,000; insurance prepaid RWF 6,000 and stock of unused stationery RWF 2,500.

Required:

1. Prepare Income and expenditure statement
2. Extract the balance sheet

Unit 5

PUBLIC SECTOR ACCOUNTING

Key unit competence: To be able to prepare accounts for public sector organizations

Introductory activity

MASENGESHO has previously worked as accountant for a limited liability company. In May 2022 he has changed the employer and became a chief accountant for Gatsibo District just during the period of closing fiscal year. One of his duties is to prepare financial statements for the district. Besides his not familiar of preparing them because he was in private sector.

Required: Enumerate five financial statements prepared in public organizations.

5.1. Public Finance management (PFM) legal framework

Learning Activity 5.1

HABAKUBANA Elaste, a budget Manager, asked you to describe the PFM cycle which is different from accounting cycle described in senior four.

Required: Convince him by describing the PFM cycle.

5.1.1. Introduction to Public Sector Accounting

According to International Public Sector Accounting Standards Board (IPSASB), the term" Public sector" refers to national governments, Regional (eg: State, provincial, territorial) governments, local (eg; City, town) governments and related government entities (eg; agencies, boards, commissions and enterprises).

Public sector plays a fundamental role in the political and economic structure of a country.

The Rwanda Public Sector consists of the Following:

- Central Government, Ministries, Donor projects, Embassies
- Local government eg. Kigali city council
- Public enterprises or parastatals eg. RITCO, WASAC, National post office, BNR
- Charitable organizations

Government organizations differ from business organizations discussed in previous units in that:

- Governments have no stockholders or other owners;
- They render services with no expectation of earning profit, and
- They have power to require taxpayers to support financial operations whether or not they receive benefits in proportion to tax paid.
- Similarly, non-profit organizations exist to lender services to the people with no expectation of earning profit from those services, have no owners, and seek financial resources from persons who do not expect either repayment or economic benefits in proportion to the resources provided
- Governments and non-profit organizations are governed mainly by their budgets not by the market place. Through the budgetary process, these organizations control or strongly influence both their revenues and expenditures.

Public sector organisations provide a great number of diversified services to the community. These organisations are also regarded non-profit organisation. All public sector bodies have one feature in common. Their specific powers are derived from parliament and their responsibilities are ultimately to parliament.

Examples of public sector activity may include delivering Social security; administering urban planning and organizing national defence.

The organization of the public sector can take several forms, including:

Direct administration funded through taxation; the delivering organization to meet commercial success criteria and production decisions are determined by the government.

5.1.2. Public finance

Public finance describes finance as related to sovereign states and sub-national entities (states/provinces, countries, municipalities, etc.) and related public

entities (eg. schools, districts) or agencies.

Public finance is concerned with:

- Identification of required expenditure of a public sector entity
- Sources(s) of that entity's revenue
- The budgeting process
- Debt issuance (municipal bonds for public sector works projects)

Public Finance deals with the finances of public. It thus deals with the finances of government. The finances of the government include the raising and disbursement of government funds. It is concerned with the operation of the public treasury.

5.1.3. Role of Public sector in the economy

In the developing countries also the growth of public sector has been phenomenal.

a) Information control

To ensure that the general public has adequate information to make informed choices, the government ensure that business make available all necessary information to the public. This includes proper labelling on all goods available for sale. In this way, the government protects public health and safety.

b) Monopoly control

To keep any one business or company from becoming too powerful and concerning the market place, the government has to create antitrust laws to control or break up any monopolies. This allows the consumer to have a variety of fair option the market to choose from.

c) Regulation Control

To ensure that the businesses are held accountable for their actions, the government has created strict regulations for each different type of business. Individual businesses must take ownership of any negative effects created while doing business. Any example of a business creating negative effects includes a factory creating pollution.

d) To drive Economic Development

Most countries desire to achieve a high rate of economic development. However, the resources required to achieve the desired growth far exceeds the resources of local private enterprise and spontaneous will proactively intervene through the concept of state entrepreneurship

e) Industrialization

Industrialization is the most important requisite for economic development. Industrialization in the developing countries necessitates the extension of the public sector. In the developing countries the state is the only force that possesses the necessary levers for influencing the economy, the means for mobilizing and properly utilizing financial, natural, labor and material resources, applying scientific and technological achievements and overcoming a number of difficulties and contradictions typical of developing countries.

f) Promotion of Science and Technology & Research

Scientific and Technological revolution has an important bearing on economic development.

The public sector has become the instrument for the development of science and technology and also the vehicle for the application of scientific and technological achievements in industrial and agricultural production.

g) Planning

Economic planning also has provided a stimulus to public sector in many countries. Expansion of the public sector is essential to make planning more effective.

h) Public Utilities

There are certain types of services known as public utilities such electricity, city transportation, water supply, railways, etc., are the examples of public utilities.

The provision of these services needs huge investment. They are also monopolistic in nature. It has been realized that these services can be provided efficiently, economically and continuously only when the public utilities will be owned and operated by the state

i) Resource Allocation

The nature and pattern of resource allocation has an important bearing on economic development. The main reason for the expansion of the public sector in India, for example, lies in the pattern of resource allocation fixed in the plans. The nature and volume of public investment substantially affects the tone and texture of economic activity.

j) Prevent Exploitation

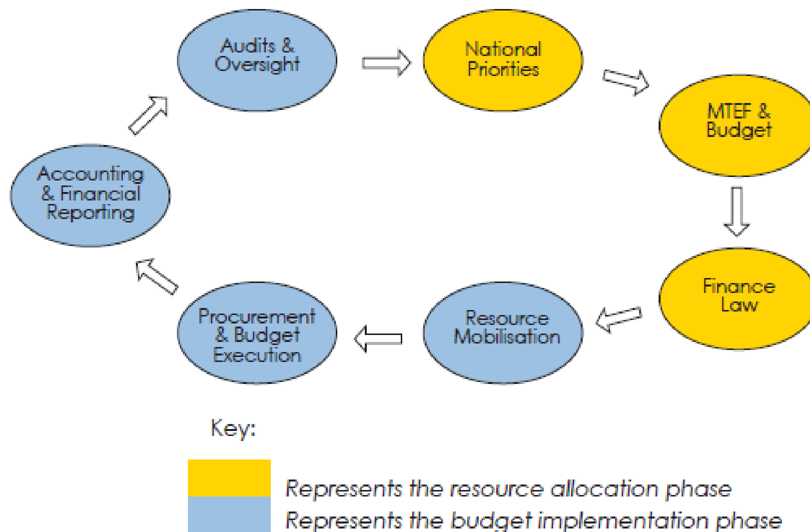
Sometimes the monopolist private producers have a tendency to reduce their output and raise the prices, and thus exploit the consumers in the process. Public takeover through nationalization a method by which exploitation of consumers can be prevented

5.1.4. PFM Legal Framework and Institution Arrangement

a) The public Finance Management Cycle

The government of Rwanda Public finance management(PFM) cycle entails determination of national priorities, developing MTEF and the Budget, preparation and approval of the finance law, resources mobilization, procurement and budget execution, accounting and financial reporting, audit and legislative oversight.

PFM cycle



The PFM cycle described above generally covers a three years' period. Therefore, at any one point in time, three years budgets are at different points in the cycle: for example, in October of any year, the budget of the previous year is being audited, the budget of the current year is being executed, and next year's budget preparation has already started.

b) PFM legal framework

Laws and regulations: The Government has put in place laws and regulations to enforce an effective and functional PFM system.

- **The 2003 Rwanda Constitution (as revised in 2015)** especially Articles, 162,163,164,165,167,166,167 dealing with the PFM function of GoR.
- **Organic Law No12/2013/OL on State Finances and Property of 2013** which is the principal law on the financial management within the Government of Rwanda and is subsidiary to the constitution.

Under Article 13 of Organic law on State Finance and Property; Minister has the responsibility to enforce this Organic law and any prescribed norms and standards including any prescribed standards of accounting practice and uniform classification systems, in central and local Government administrative entities.

- **Ministerial order no 001/16/10/TC** of 26/01/2016 relating to Financial regulations, 2016 on the Organic on State Finances and Property – which elaborates more on the implementation of the Organic law on State Finances and Property of 2013.
- **Laws and regulations on public procurement –** which prescribe the procurement procedures within the General Government
- **Law** establishing sources of revenues and property of decentralized entities- which provides for the list of taxes, fees and other charges levied by decentralized entities and determining their thresholds. Law describes and regulates the sources of revenues for decentralized entities in Rwanda.
- **Laws on Taxes** – which prescribe provisions, on which tax payers including government agencies must also, adhere to in fulfilling tax obligations. They include:

i. Law on direct taxes on incomes as modified and complemented to date;

ii. Law establishing the value added tax

iii. Law on tax procedures as modified and complemented to date;

iv. Ministerial Order and Commissioner General's governing direct taxes on income; and

v. Any other law or modifications to the above laws.

Human resource management and payroll – the following legislations govern human resource management and payroll:

- Law regulating labor in Rwanda;
- Law on general statutes for Rwanda Public service;
- Presidential Order governing modalities for the recruitment of public servants;
- Presidential Order determining the amount of salaries and other fringe benefits to state high political leaders and modalities of their allocation;
- National employment policy;
- Guidelines for fixing salaries in the Rwandan Public Sector;
- Any other law or modifications to the above laws.

- **Asset management** – underpinned by the following laws, regulation, policies and procedures:
  - Ministerial order determining the organization and functioning of the asset disposal evaluation committee to set value for state private assets to be sold, exchanged, donated or completely destroyed;
  - The fleet policy of government of Rwanda;
  - Law on disposal of state assets which determines the procedure governing the disposal of State private assets; and
  - The law governing privatization of public institutions and national investment.
  - Any other law or modifications to the above laws.

C) PFM Institutional arrangements

In accordance with Article 61 and 65 of the 2003 Constitution of Rwanda as revised in 2015, the PFM institutional framework of the GoR comprises of:

i. **Legislature/Parliament** – The Constitution establishes a bi-cameral parliament comprising the Chamber of Deputies (Deputies) and the Senate (Senators) to carry out legislative and oversight function by debating and passing laws. It also legislates and exercises control over the Executive.

ii. **The executive** – Article 97 of The Constitution vests all executive power on the President of the Cabinet. The cabinet is accountable to both the president and parliament in accordance with the Constitution. The Cabinet through the Minister retains the overall financial accountability.

iii. **The judiciary** – The Constitution establishes the judiciary and provides that the judicial authority is vested in the judiciary composed or ordinary Courts and Specialized Courts. Courts consist of ordinary and specialized Courts. Ordinary Courts are comprised of the Supreme Court, the High Court, Intermediate Courts and Primary Courts. Specialized Courts are comprised of Commercial Courts and Military Courts.

iv. **The Office of Ombudsman** – the Ombudsman as an independent public institution to carry out the following responsibilities:
  - To act as a link between the citizen and public and private institutions; to prevent and fight against injustice, corruption and other related offences in public and private administration;
  - To receive and examine complaints from individuals and independent associations against the acts of public officials or organs in order to find solutions to such complaints if they are well founded;
  - To receive declaration of assets of the president of the Republic, the president of the Senate, the Speaker of the Chamber of Deputies, the President of the Supreme Court, The Prime Minister; other members of

the Cabinet and other public officers entrusted with the management of state finances and property.

v. **Office of the Auditor General –** Under Article 65 of The constitution provides for the Office of Auditor general and to complete the accountability cycle, the Article 66 of The Constitution requires the Auditor General to submit an annual audited financial report to Parliament.

The audit report indicates the manner in which the budget was utilized, unnecessary expenses which were incurred or expenses which were contrary to the law and whether there was misappropriation or general misuse of public funds.

Parliament reviews, debates and provides oversight function on the executive. The Auditor general submits a copy of the report to the President of the republic, Cabinet, the President of the Supreme Court and The Prosecutor General of the Republic.

The Parliament, after receiving the report of the Auditor General referred to in this article, examines the report and takes appropriate decisions within six months.

5.1.5. Accounting Policies

In general, there are two alternative bases of accounting:

i. Cash basis of accounting

ii. Accrual basis of accounting.

The cash basis of accounting is an accounting methodology under which transactions and events are recognized in the books of accounts only when cash and cash equivalents is received or paid by the entity. Therefore, the transactions and events are recorded in the books of accounts in the period in which the associated cash flows occur.

Cash is defined as the cash on hand, cash at bank and demand on deposits. Whereas, cash equivalents is defined as short term, highly liquid investments (with maturity is less than three months from the date of purchase) that are readily convertible to known amounts of cash and which are not subject to a significant risk of change in value.

The accrual basis of accounting is an accounting methodology under which transactions and other events are recognized in the books of accounts when they occur (and not only when cash or cash equivalent is received or paid). Therefore, the transaction and events are recorded in the books of accounts and recognized in the financial statements of the period to which they relate.

The following table shows a summary of differences between the two accounting bases:

Ref	Criteria	Cash basis of Accounting	Accrual basis of Accounting
1	Recognition revenue	Recognized when received	Recognized when earned
2	Recognition expenses	Recognized when paid	Recognized when incurred
3	Time of recording	Transaction recorded at time associated cash inflows or outflows	Transactions and events matched with period of occurrence
4	Treatment of non-current assets	Acquisition and disposal of assets is treated as payment and receipt respectively	Only consumption of assets is expensed with the value of the asset recognized in the statement of financial position
5	Treatment of inventories	Expensed at the time of purchase	Recognized as current assets and expensed upon issuance for consumption
6	Treatment of public debt	Recognized as revenue at time of receipt and expensed at the time of payment	Recognized as liability at the time of receipt which is extinguished at the time of payment
7	Treatment of public debt interest	Expensed at the time of payment	Recognized when incurred

Ref	Criteria	Cash basis of Accounting	Accrual basis of Accounting
8	Treatment of prepayments	Expensed at the time of prepayment	Accrued as receivables at the time of prepayment and expensed when the actual goods or services are consumed
9	Treatment of liabilities	Not recognized	Recognized in the statement of financial position or notes in case of contingent liabilities
10	Treatment of employees benefit	Expensed at the time of payment	Accrued for at the period service is consumed
11	International Accounting standards	Applies IPSAS cash basis	Applies IPSAS accrual and IFRS

In between the basis of accounting described above, are the following modified bases of accounting:

- Modified cash basis of accounting; and
- Modified Accrual basis of accounting

Under the **Modified cash basis**, the main basis of accounting is cash i.e. for all intents and purposes economic transactions of a reporting entity are measured, recorded, and reported on the basis of cash, with a few exceptions to the general rule, where certain economic events are identified, measured, recorded and reported on, not strictly on receipt or payment, but are "accrued".

Conversely where the main basis of recognizing, measuring, recording and reporting on economic events and transactions is the "accrual basis" but the reporting entity has allowed a few exceptions to the general rule, for example certain of its expenses and or income are only recognized on cash payment (cash outflow) or receipt (cash inflow), then the basis of accounting is referred to as **"modified accrual basis".**

Except for the subsidiary entities affiliated to the centralized entities, public entities were used to maintain their books of accounts on a modified accrual basis of accounting.

The subsidiary entities affiliated to the decentralized entities were used to maintain their books of accounts on a modified cash basis of accounting and progressively move to the same accounting basis as that of the rest of the public entities but now the Government of Rwanda is moving to accrual basis in maintaining its books of account.

Application activity 5.1

1. There are several arguments that justify government intervention in economies. **The following are included in these reasons with exception of:**

   A. Market Failure

   B. Redistribution

   C. Political ideology

   D. Monetary Policy

2. **Choose the most accurate statement among the following in relation to Public Finance Management (PFM) cycle**:

   A. In Rwanda, the government's national budget runs from 30 June to 1 July

   B. In Rwanda, budgets should be approved by the legislature, which should be able to effectively scrutinize government plans

   C. In Rwanda, annual financial reports should be subject to dependent external audit and scrutiny

   D. There should be no predictability but control in the budget execution

In public finance management, the three fundamental aspects to treasury management include:

i. The financing of operations in a way that minimizes funding costs and matches cash flow needs

ii. The management of working capital

iii. The management of financial risks to which cash flows are exposed

   A. (i) Only

   B. (i), (ii)&(iii)

   C. (i)&(iii) only

   D. None of the above

5.2. Record Government Revenues and Expenditures

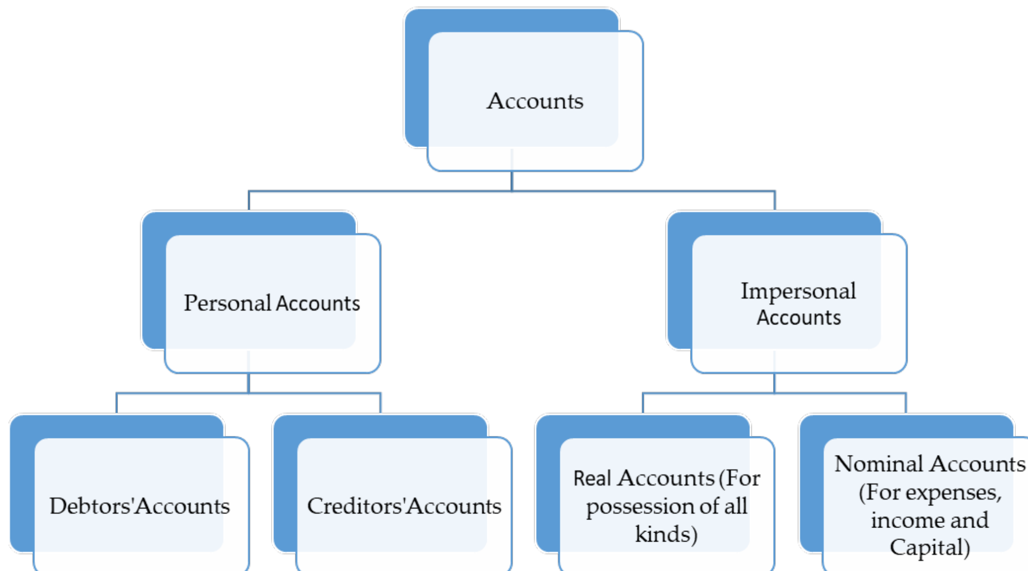
Learning Activity 5.2

You are hired as a public accountant, what are the minimum books of accounts will you keep?

5.2.1. Books of accounts

The finance department shall maintain the necessary books of accounts to ensure that financial information is comprehensive. In keeping books of accounts, double entry concept will be applied. This entails that a financial transaction gives rise to two equal and opposite entries one debit and the other credit.

An account is a record in ledger form summarizing all the transactions that have taken place to a particular event or activity that ledger record relates. These can be classified as Personal and Impersonal Accounts. Personal accounts are those that relate to debtors and creditors (customers and suppliers) while Impersonal Accounts can be divided between Real account and Nominal accounts. Real accounts are those in which possessions are recorded such as buildings, machinery, fixtures and fittings, stocks while nominal accounts are those in which expenses, income and capital are recorded.



Public entities should at a minimum maintain the following books of accounts in electronic or manual form:

1. Cash book
2. Petty cash book
3. General ledger
4. Accounts payable ledger
5. Accounts receivable ledger
6. The journal

Note: Description of the books above have been seen in Senior 4 units 3 and 4

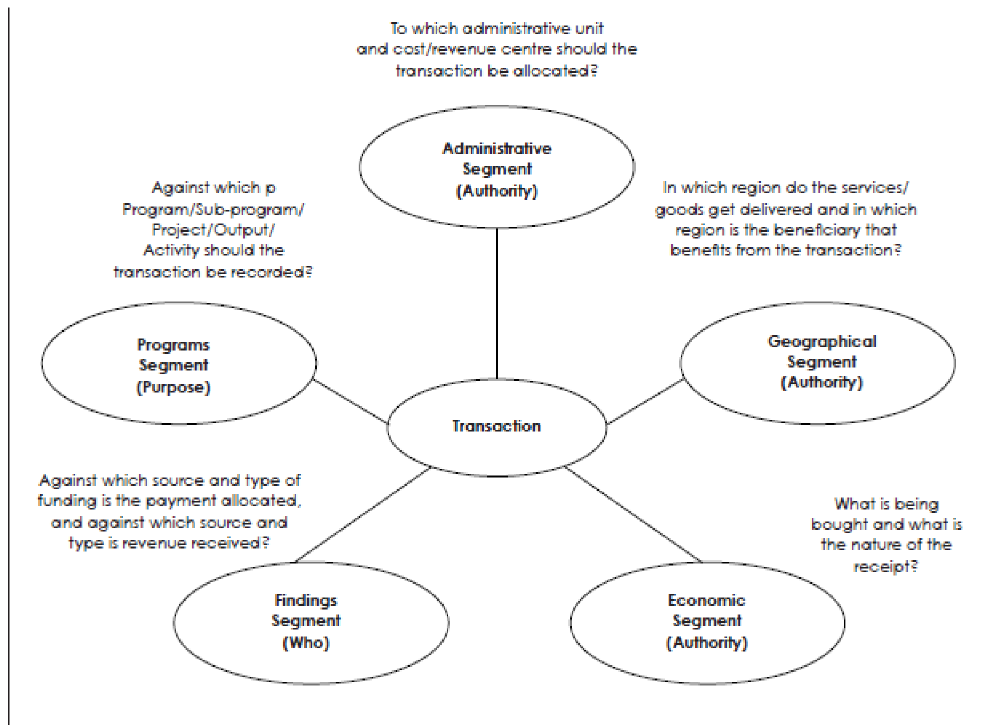
5.2.2. Government standard chart of accounts

1. Overview of the Standard Chart of Accounts

The Standard Chart of Accounts (SCoA) is a classification system by which financial transactions are recorded. Article 97 of the Ministerial Order No. 001/16/10TC of 26/01/2016 relating to financial regulations requires the Minister and upon the advice of the Accountant General to issue a standardised Chart of Accounts generally applicable to all public entities excluding public institutions. Under the regulations, public institutions are empowered to develop their own chart of accounts adapted to their financial operations. The SCoA provides a basis for a uniform budget classification and execution. It is mandatory for all Government entities within general Government to use the coding structure of SCoA to budget and execute the budget. For entities using IFMIS, the SCoA is already set up in the system, however, for entities using stand alone systems the SCoA has to be set independently.

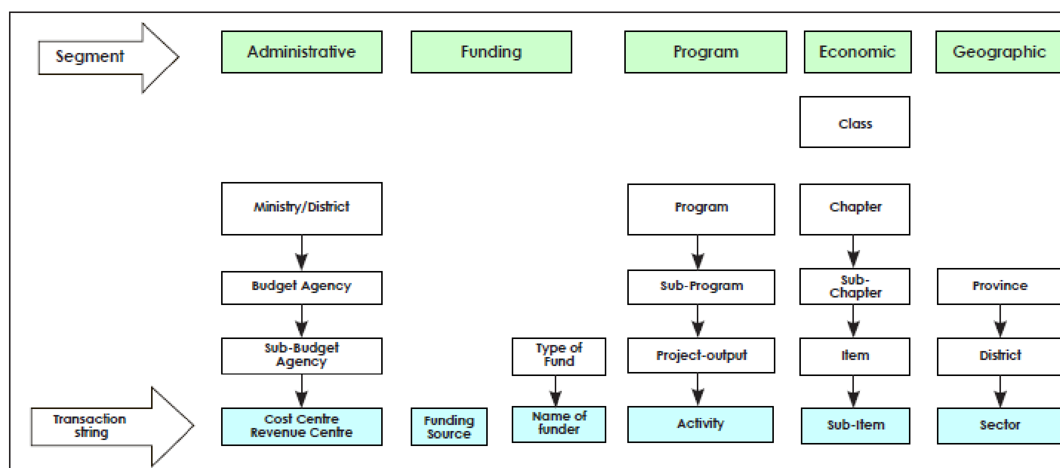
Consistent with Article 97 of the Ministerial Order No 001/16/10/TC of 26/01/2016

Relating to financial regulations, the coding structure of the SCoA comprises five segments. When recording a transaction, a selection must be made from each of the five segments, meaning that all segments must be used for recording a single transaction by answering the questions provided in the diagram below:



1. The structure of the SCoA

The diagram below illustrates the structure of the SCoA of the Government and shows the interaction between the segments and classifications within each segment



The following is a description of each of the five segments of the SCoA:

a) Administrative Segment

This is based on administrative responsibility, which Executive (Ministry/

District) has overall responsibility and accountability for the inflows and outflows of financial and other resources, and also provides for the lower delegated levels of responsibility and accountability.

The administrative segment provides for four levels as follows:

- Level 1 – Ministry/District: represents the highest level of administrative responsibility
- Level 2 – Public entity: represents the public level where budget appropriations are made.
- Level 3 – Sub public entity: at the disposal of the public entities which may wish to drive accountability to lower levels of their structures.
- Level 4- revenue/cost centre: at the disposal of the public entities which may wish to drive accountability to lower levels of their structure

b) Fund Segment

This segment defines the source and type of funding. The segment helps track revenues and expenditures per source and type of funding. The segment applies to both revenues (inflows) and expenditures (outflows). "Source of funding" defines the source of funding for inflows.

In broad term, there are two broad sources of revenues – Domestic and External sources. Domestic sources may be from Government of other local institutions and individuals.

c) Program/Function/EDPRS Segment

This segment defines the purpose of the transactions through programmatic classification. The Government programmes and sub-programmes reflect Government policy, goals and objectives.

d) Economic Segment

This segment defines the natural accounting nature of the transaction, vis-à-vis, revenue, expense, asset, liability and capital (consolidated fund). The classification includes the five (5) classes accordingly. The economic classification is closely aligned to the GFS system in terms of operating revenues and expenses.

The categorisation for economic item under the chart of accounts is classified as follows: Class – Chapter – Sub-chapter – Item – Sub-item.

The following illustrates coding under the economic segments of the SCoA:

Ref	Description	Which Chapter>Sub-Chapter>Item>Sub-Item does the transaction fall?				
		Class	Chapter	Sub-Chapter	Item	Sub-Item
Case 1	Nyarugenge district collects market fees in Nyamirambo market	1 (Revenue)	14 (Other revenues)	142 (Sale of goods and services)	1422 (Sales by Market Establishment)	142103 (Market Gate Entry fees)
Case 2	After an employee was unable to pay off a saloon car loan, MININFRA recovered the car and it sold off.	1 (Revenue)	15 (Disposal of Assets)	151 (Disposal of Tangible Fixed Assets)	1512 (Transport Equipment)	151201 (Saloon vehicle)

e) Location Segment

The geographical segment defines where the authority for budget execution (e.g. expenditure) lies. However, some expenditure made centrally for example in a Ministry Headquarters will actually be benefiting the people in a district, e.g. the building of a district hospital or school.

This segment comprises 5 digits and provides for classifying the beneficiary of the spending by Province, District (Akarere) and Sector (Umurenge). The following illustrates coding under the location segments of the SCoA:

Ref	Scenario	Geographic code
1	Bugesera district buys computers for its human resource department.	Bugesera – (50700) (Expenditure in districts is unlikely to be benefiting other Districts or Kigali city)
2	MINISANTE is funding the construction of health centre in Kigina sector, Kirehe district. Which geographic code should MINISANTE apply?	Kirehe – (50503) (Even though MINISANTE is located in Kigali city, the expenditure is benefiting Kirehe district.)

3. Updating the Government SCoA

The accountant General may on his or her own or, on the proposal of a Chief Budget Manager modify the Chart of accounts. The final authority for updating the chart of accounts rests with the Accountant General.

The following procedures will be followed in updating the chart of accounts:

a) Where a Chief Budget Manager has identified the need for new accounts codes, he or she apply to the Accountant General for the new codes.

b) The Accountant General shall review the request submitted and determine whether it is justified after making any consultations that he or she may consider necessary. Where the request is not justified and the existing Chart of accounts can be used to track the transactions, the Accountant General shall advise the Chief Budget Manager on which codes to use and how to report on their transactions.

The Accountant General shall publish the updated CoA whenever an updates is made

5.2.3. Purpose of Government Accounting

The purposes of government accounting include:

- Demonstrating the proprietary of transactions and their conformity with the law, established rules and regulations
- Measuring current performance
- Providing useful information for the efficient control and effective management of government operations
- Facilitating audit exercise to be carried out
- Planning future operations
- Appraising those in the authority, in efficiency and effectiveness

Users of Government Accounting Information

There are two groups of users of Government Accounting information: internal and External.

Internal Users and Interest Areas

This group of users includes:

- **The Labour union** in the public service which will press for improved conditions of employment and security of tenure for their members.
- **The Members of the Executive Arm of Government:** such as the President, Ministers, Governors, and Mayors. Their interest areas are to ensure probity and accountability through score keeping and performance control which are achieved through accounting information.
- **The Top Management members:** Permanent Secretaries of various Ministries for example. They are the conduit of accounting information generation and transmission and serve as liaison officers between Government, employees and the public.

External Users and Areas of Interest

External Users include

- **Members of the Legislature** at both National, State and Local Government levels. Information in the accounts of Government is the major media through which politicians render stewardship to their constituencies and appraise them of the endeavours of governance.
- **The Members of the Public,** to demonstrate accountability and assist the people to appreciate or otherwise the efforts of Governments

- **Researchers and Financial Journalists:** Researchers are expected to develop new and better ideas of governance. Financial journalists cherish accounting information to advise existing and potential investors.
- **Financial Institutions,** such as Commercial Banks, World Bank, International Monetary Fund. Accounting information assists them to evaluate the credit rating of a borrowing Nation.
- **Governments, apart from the ones reporting:** Governments collaborate on ideas of investment and research. They require accounting information on the well-being or otherwise of each other.
- **Suppliers and Contractors:** Suppliers and contractors are eager to ascertain the ability of a Government to pay for goods and services delivered. Only Accounting information can be revealing.

5.2.4. Source of Government Finance

The Government revenue means the amounts which are received by the Government during a particular year. In other words, the income of the Government is known as public or government revenue. The sources may be classified as:

1. Internal sources
2. External sources

These sources are explained as under:

I. Internal sources

Internal sources consist of those amounts which are received by the Government internally or from the individuals of the country. The main internal sources of revenue of Rwanda Government are:

- **Direct taxation**

This taxation includes income tax, corporation tax and capital gains tax. About 70% of Rwanda Government's revenue comes from direct taxation.

- **Indirect taxation**

Indirect taxation includes:

1. Tax on domestic manufacturers
2. Customs duty on import and exports
3. **Excise duties**: It is duty imposed mostly on production activities for sales purposes, largely collected at manufacturing stage, showing downward trend

4. VAT

Indirect taxation is the major source of Government revenue from internal sources. This taxation contributes about 50% of Government revenue in Rwanda.

- **License fees**

The Government of Rwanda receives fees from business and trading licenses, license fees under traffic act and other miscellaneous licenses. This source contributes about 5% of Government revenue in Rwanda.

- **Fines and penalties**

Fines and penalties is another source of revenue. These fines and penalties are imposed on the individuals for not obeying the laws, rules and regulations of the country. This source contributes about 5% of total income of Rwanda Government from internal sources.

- **Sale of goods, services and properties**

The Government also receives income from the sale of different goods and services properties. About 3% to 4% of income of Government of Rwanda comes from this source

- **Rent**

Closed school buildings, empty state-owned buildings, and park shelter and reception facilities are examples of facilities that can be rented out. Government agencies also earn rent proceeds for the use of property by other agencies. For example, if the federal government needs space in a small town, the feds might arrange to rent out an unused office in the town hall from the municipality. Unusable properties are sold off.

- **Investments**

Government sometimes uses revenues as a means of earning interest and dividends. While the investment might be made up of tax francs, the interest, dividends and capital gains are considered non-tax revenue. The investment opportunities might be in the form of mutual funds, bonds, foreign exchange rates and government-backed loans to businesses and individuals, such as small business loans and mortgages.

- **Grants and Gifts**

Gifts are Voluntary contributions by individuals or institutions to the government. Gifts are significant source of revenue during war and emergency. A grant from one government to another is an important source of revenue in the modern days.

The government at the Centre provides grants to State governments and the State governments provide grants to the local government to carry out their functions. Grants from foreign countries are known as Foreign Aid. Developing countries receive military aid, food aid, technological aid, etc from developed countries.

- **Borrowings**

The government may force various individuals, firms and institutions to lend to it at a much lower rate than the market would have offered.

- **Other sources**

In addition to the above sources, the Government receives income from some other miscellaneous sources. These sources contribute a small amount of Government revenue.

II. External sources

External sources of Government revenue consist of external loans and grants. These loans and grants are obtained by the Government for development purposes. These loans and grants are the main sources of income of capital budgets.

These loans and grants are obtained from different countries and international organizations. The Rwanda government obtains loans and grants mainly from the U.S.A, Germany, Japan, Netherlands, Denmark, U.K and so on.

The main international organizations which provide loans to Rwanda are World Bank, African Development Bank, International Monetary fund, Arab League, European Economic Community, International Development Agencies, etc

Government expenditure

Government expenditure means those amounts which are spent by the Government for different purposes. The Government expenditure may be classified as:

a) Recurrent expenditure
b) Development expenditure

These are explained as under:

Recurrent expenditure

Recurrent expenditure means revenue expenditure. This expenditure is

incurred by the Government on normal activities. The amounts which are spent by the Government on regular activities like defense, health, education, administration, etc, are referred to as recurrent expenditure the main expenditure heads of recurrent expenditure are:

General public administration

This expenditure is incurred on general administration of the country. About 10% to 15% of total expenditure in Rwanda is incurred for this purpose.

Defense

Defense of the country is of great importance for its stability. The government of Rwanda spends about .... % of recurrent expenditure on the defense. This percentage is very low as compared to other countries.

Education

Education is the main priority of Rwanda Government. About 20% to 25% of recurrent expenditure is incurred on education.

Health

The government spends on health facilities. About 6% of recurrent expenditure is incurred for providing health services.

Social welfare

The government of Rwanda spends on social services like housing, sports; etc the share of this head in total recurrent expenditure is about 2%.

Economic services

The government of Rwanda spends huge amounts on providing economic services. These include agriculture, forestry, fishing, electricity, gas, water, transport and communication, etc. About 16% of total recurrent expenditure is incurred for this purpose.

Other services

There are some miscellaneous items of recurrent expenditure. About 30% of total expenditure is incurred for this purpose.

Development expenditure

Development expenditure is incurred for the establishment of new agricultural and industrial projects, installation of new plant and machinery, construction of new roads and buildings, purchase of new equipments etc.

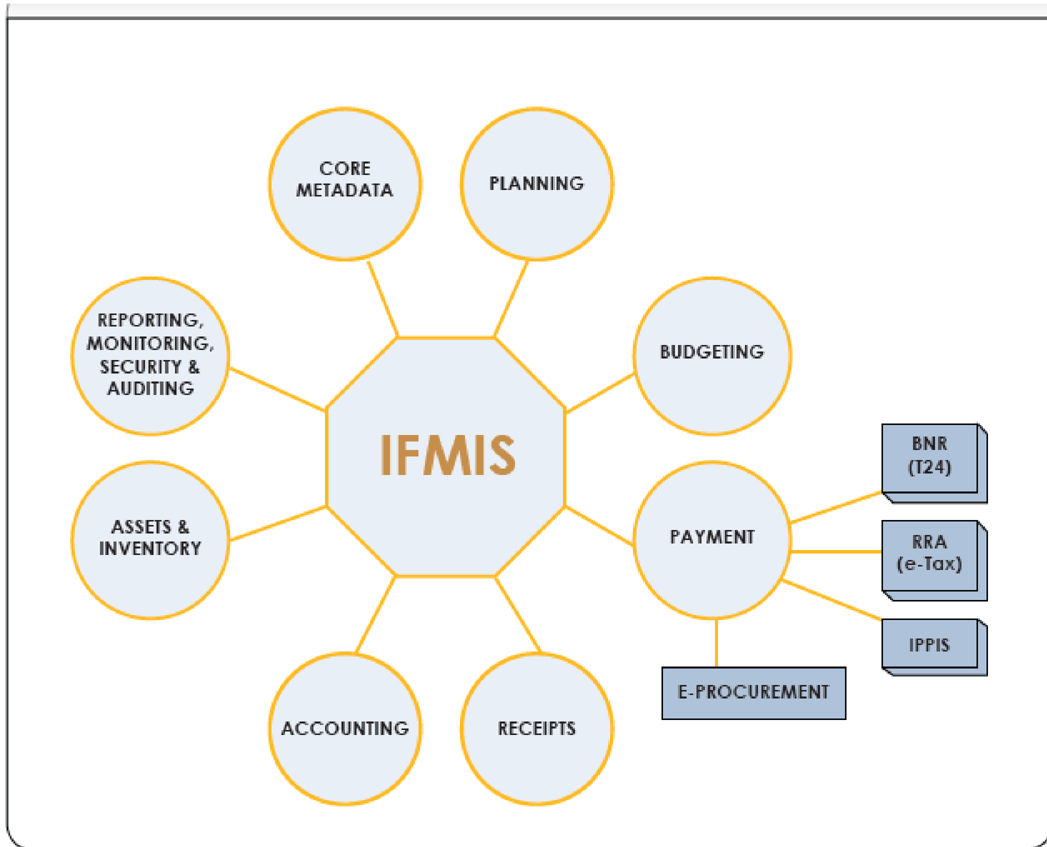
Development expenditure is mainly financed from external loans and grants. Internal borrowing is also another source of financing the development expenditure. Development expenditure is shown in capital budget.

5.2.5. Role of IFMIS in Effective PFM

The Government has put in place an Integrated Financial Management Information System (IFMIS**)** as the principal system of Government for financial management. It is intended that the system will cover all the General Government entities with the implementation being carried out in a phased manner. Accordingly, the IFMIS shall be used for the following purposes:

- Centerpiece of the government financial management processes of planning, budget preparation, budget execution, revenue management, inventory management, assets management, accounting and financial reporting.
- Preparing financial management reports: these enable improved management decisions making through provision of real time financial statements.
- Harmonizing processing of transactions: transaction processing across Government is made uniform through use of SCoA therefore offering a common integrated enterprise platform for consistency in process and procedures;
- On-line inquiries: users can access the system from any location with the required authorization details;
- Controls for commitments, expenditure and budgetary adjustments are made possible; and
- Special accounting needs such as development projects and special funds are also provided.

The figure below summaries the typical structure of the IFMIS



5.2.6. Recording Government Revenue and Expenditure

Although the recording of government revenue and expenditure is based on the concept of double entry but the procedure of recording transactions in the government sector is different from a commercial enterprise. In the government sector, the theory of fund accounting is followed.

A fund is an independent fiscal and accounting entity with resources and obligations. Each government unit can be regarded as a fund and complete accounting records maintained for each fund. There are various government ministries and in each ministry there are various departments. For example, the ministry of commerce has the following departments:

General administration and planning

- Department of internal trade
- External trade services
- Inspectorate of weights and measures

Each department of the ministry of commerce can be regarded as a separate fund.

Major steps in the government accounting in Rwanda are the following:

Annual estimates

These estimates are prepared by the various ministries and these submitted to the treasury. These estimates include revenue and expenditure figures for the next year.

Presentation of the budget

The Minister of finance presents the budget for the next financial year before the parliament in the month of June every year. The financial year of the government starts from 1st July and ends on 30th June next year.

The budget contains the estimate of government revenue and government expenditure for the next year. The various proposals of the budget are debated in the parliament. After the approval of the parliament the budget is implemented.

Spending by Ministries

Some specific amounts are appropriated by the Parliament to different ministries. The government ministries can spend the amounts appropriated to them. Appropriated amounts can be used by the ministries to perform their duties, there are different vote numbers assigned to different ministries.

These votes may be further divided into recurrent (R) and development (D) votes. These vote numbers are used for reference purposes. For example, vote R- 11 and D11 are recurrent and development vote numbers for the ministry of health. In each Ministry, there are sub votes for different departments of any ministry.

The Fund System of Governmental Accounting

Public funds are monies owned by the Nation and controlled and applied by the central government for public works and services. In Rwanda, all resources (revenue from tax, non-fiscal revenues) are recorded into a fund known as a consolidated fund. The consolidated fund account is kept by the treasury under the ministry of finance, and all revenues and grants received by the Government are paid into this account. No money can be withdrawn from this account without approval of Parliament, i.e. Parliament is the sole signatory to this account.

The fund accounting system is a concept which is used to describe how government resources are accounted for from one major fund source. The word fund is therefore used to describe the whole government set up as one big fund in terms of structure.

Governmental fund

Government funds are used to finance general government activities such as police and fire protection, courts, inspection, and general administration. Most of their financial resources are subsequently budgeted (Appropriated) for specific "general government" uses (expenditures) by the legislative body.

Government funds include:

- The general Fund
- Special Revenue Fund
- Capital Project Funds
- Debt Service Funds

The accounting equation of most governmental funds is:

Current Assets – Current Liabilities = Fund Balance

Thus, Governmental funds are essentially **"Working capital"** funds and their operations are measured terms of sources and uses of working capital, that it is, changes in working capital.

When Fund Balance is positive, there is a greater likelihood that the government will pay it is liabilities. When Fund Balance is negative, short term creditors may not be paid, and public organization may be forced into bankruptcy.

A. The General Fund

The primary governmental is used to account for most routine operations of the governmental entity. All general governmental resources that are not required to be accounted for in another fund are accounted for in the General Fund.

- General fund revenue consists primarily of taxes (Property, sales, income, and excise), licenses, fines, and interest.
- General fund revenue expenditures are budgeted and appropriated for by council or other legislative body.

Typical journal entries include:

a) To record the budget :

Estimations revenues	XX	
Appropriations		XX

Fund Balance for the last year XX

Note: The budgetary entry causes the Fund Balance account to be carried during the year at it is planned end of year balance.

b) To record revenues

Cash or receivable XX

Allowance for collectives' receivables XX

Revenues XX

c) To record collection of receivables and write off of uncollectible

Cash or receivable XX

Receivable XX

Allowance for uncollectible receivables XX

Receivable XX

d) To record purchase order issued or contract commitment

Encumbrances (Expected expenditures) XX

Reserve for encumbrances XX

e) To record Expenditures upon receipt of invoice

Reserve for encumbrances XX

Encumbrances (Expected expenditures) XX

Expenditures (Actual cost) XX

Vouchers Payable XX

Note: While goods and services committed for by purchase order or other contract are encumbered in governmental funds to avoid overspending appropriations, many expenditures are controlled by other means and need not to be encumbered. For example, wages are set by contract and controlled by established payroll procedures and are not encumbered.

f) To record supplies

Supplies inventory XX

Fund Balance reserve for supplies inventory XX

The supplies inventory indicates that portion of fund balance is not available

Note: This customary entry compounds these two more proper entries.

6a. Supplies inventory	XX	
Fund Balance	XX	
6b. Fund Balance	XX	
Fund balance reserve for supplies inventory		XX

The entry (ies) would be reversed had supplies inventory decreased. The increase (decrease) in supplies inventory is reported as an "**other Financing Source (Use)"** in the governmental fund "**Operating Statement"**, the statement of Revenues, Expenditures, and Change in Fund Balance.

g) To record closing entries at year end

Revenues	XX	
Appropriations (budgeted)	XX	
Collection of prior year error	XX	
Fund balance (difference – Debit or credit)	XX	
Estimated revenues	XX	
Expenditures	XX	
Encumbrances	XX	
Cumulative effect of change in accounting	XX	

Appropriations is the authorizations of asset outflows of uses estimated of fund working capital

h) To record encumbrance reversing entry – beginning of next year

Encumbrances	XX
Fund balances (reserves)	XX

The encumbrance system is used in most governmental fund to prevent over expenditure and to demonstrate compliance with legal requirements. When it comes to close the end of fiscal year the *encumbrance account is credited*.

B. Special Revenue Funds

They are used to account that are externally restricted or designated by the

legislative body for specific *general government purposes.* For example, motor fuel taxes used to finance the provincial road construction would be accounted for in a Special Revenue Fund.

C. Capital Project Funds

The capital project funds used to account for acquisition and use for financial resources to construct or otherwise acquire long-lived general government real property and equipment. For example, to construct a new city hall, conference center, stadium, Airport.

D. Debt Service Funds

The Debt Service Funds used to account for repayment of all general government long term debit recorded in the General Long Term Debt Account Group and payment of related interest and fiscal agent charges. Debit Service Fund budgetary may be used to record the estimated revenues (e.g., from taxes), estimated other financing sources (e.g. from inter fund transfer from General Fund) and estimated income (e.g., from investment)

Example:

1. To record tax revenues and other financing sources

		Dr	Cr
Cash or receivables		XX	
	Allowances for uncollectible taxes		XX
	Tax revenues		XX
	Operating transfer from General Fund		XX

2. To record investment made

		Dr	Cr
Investment		XX	
	Cash		XX

3. To record investment income

		Dr	Cr
Cash		XX	
	Investment revenues		XX

4. To record expenditures for debt principal retirement (at maturity date) and interest (at due date)

		Dr	Cr
Expenditures		XX	
	Bonds payables (At maturity date)		XX

Interest payable XX

5. To record payment of matured debt and interest due

Bond payables XX

Interest payable (At maturity date) XX

Cash XX

E. Account groups

Account groups are memorandum list and offset accounts that provide a record of general government fixed assets and long term debt, which are not recorded in the governmental funds.

Account groups include:

The general Fixed Assets Account Group (GFAAG)

The account group accounting equations are:

GFAAG: General Fixed Assets = Investment in General Fixed Assets

GLTDAG: Amount Available in Debt Service Fund for GLTD Retirement

\+ Amount to be provided in Future Years for GLTD Retirement

= General Long Term Debt Payable

Example for some records:

1. To record general fixed assets (e.g., Police cars fire trucks) acquired the General Fund or Special Revenue Funds:

Machinery and equipment (Police cars or fire trucks) XX

Investment in General Fixed Assets XX

2. To record general long term debt incurred

Amount to be provided for payment of bonds XX

Amount to be provided for payment of long-term notes XX

Amount to be provided for payment of capital lease principal XX

Bonds payable	XX
Long term notes payable	XX
Capital lease (Principal) payable	XX

Proprietary Funds

Proprietary funds are used to finance a government's self-supporting "business type" activities (e.g., utilities).

Proprietary funds include:

- Enterprise Funds (Electricity, Gas, water)
- Internal Service Funds (supplies, photocopies)

The accounting equation of proprietary funds:

$$curr.\ Assets + Fixed\ \ Assets + Other\ Assets$$

$$-Curr.Liab. + Long\ term\ Debt + Contrib.Capital$$

$$+Retained\ \ Earnings$$

The accounting equation of proprietary funds is identical to that of a business corporation, it includes accounts for all related assets and liabilities, not just for current assets and current liabilities as well as for contributed capital and retained earnings.

Proprietary fund operations are measured in terms of revenues earned, expenses incurred, and net income or loss.

Sample entries:

1. To record operating revenues :

Cash	XX	
Revenue from sale		XX
Revenue from appliances		XX
Revenues from Other		XX

2. To record governmental grants for operating and capital purposes

Cash or receivables	XX	
Cash construction		XX

Revenues – State grants		XX
Contributed capital (Capital Grant)	XX	

3. To record operating expenses

Expenses - cost electricity purchased	XX	
Expenses – depreciation	XX	
Expenses – Salaries and wages	XX	
Expenses – other	XX	
Accumulated depreciation		XX
Cash		XX
Payable		XX

4. To close the account at year-end

Revenues from sales	XX	
Revenues from sale of appliances	XX	
Revenues – State Grants	XX	
Revenues from Other	XX	
Expenses –cost purchased		XX
Expenses –depreciation		XX
Expenses Salaries and Wages		XX
Expenses – Interest		XX
Expenses – Other		XX
Retained earnings (Dr or Cr)		XX

– The General Long-Term Debt Account Group (GLTDAG)

Fiduciary Funds

Fiduciary Funds are used account for government's fiduciary or stewardship responsibilities as an agent (Agency Funds) or trustee (Trust Funds) for other governments, funds, organizations, and or individuals.

Fiducially funds include:

- Nonexpendable Trust Funds (e.g., Donations)
- Expendable Trust Funds (e.g., library books)
- Pension Trust Funds (Pension, retirement)
- Agency Funds (e.g, City, Schools district…)

Expendable Trust Funds are accounted for like governmental funds, and both nonexpendable Trust Funds and Pension Trust Fund are accounted for like proprietary funds. Agency Funds are purely custodial (Current Assets = Current Liabilities).

For agency Funds, the government has no **equity.** Further, Agency Funds do not have **operating** accounts and no operating statement is prepared for Agency Funds.

F. Some Special Funds

In relation to fund accounting in the public sector, there are some special funds which are established. These are explained as under:

a) Trust funds

Trust funds are those funds whereby the government receives money in the capacity of a trustee e.g. Survivors fund, widows and children's pension fund. In this fund, all married civil servants contribute a certain amount of their monthly salaries and they get the refund on the retirement. Some other examples of trust funds are former known as National Social Security Fund (N.S.S.F) and RAMA. (Currently known as RSSB: Rwanda Social Security Board)

A trust fund is an independent accounting entity. It may own some property and other assets like investments etc. Withdrawals from a trust fund are made in accordance with some statutory provisions. A trust fund is also known as a fiduciary fund.

b) Sinking funds

These funds are created with the purpose of the repayment of public debts. Mostly, these funds are set up by the approval of the Parliament. Some annual appropriations are made in these funds. The amounts appropriated are invested to earn some interest. When any public debt matures then the sinking fund is used to redeem this debt.

c) Revolving funds

These funds are also set up by the approval of the parliament. These funds provide the financial resources for achieving some specified objectives. Some Government enterprises are set up through revolving funds. The initial

appropriation in these funds is made out of the consolidated fund. The receipts generated in such funds are automatically used by the respective enterprises in accordance with the provisions of the Act that set up the fund.

d) Capital project funds

The purpose of capital project is to provide resources for the completion of some specific capital project. Main sources of financing include the proceeds of bond issues, grants and transfers from other funds. A separate capital project fund is created for each major project.

Conclusion

Most governmental fund accounting systems use both budgetary accounts and regular accounts

- Budgetary accounts are nominal accounts used to record approved budgetary estimates of revenues and expenditures (appropriations)
- Regular accounts are used to record the actual revenues, expenditures and other transactions affecting the funds

The followings accounts are usually employed in governmental funds:

- **Estimated revenues:** Estimated sources of fund working capital. The estimated account is debited to record the revenue budget and is closed at the end of the period.
- **Appropriations:** Estimated uses of fund working capital (except for other financing uses). The appropriation account is credited to record the budgeted expenditures and is closed at the end of the period.
- **Revenues**
- **Other financing sources: Non revenues sources**
- **Expenditures**
- **Fund balance and Reserve**

Application activity 5.2

A police department orders some stationary on 11 December 2012. On 15 December 2012, the police department received an invoice requesting payment for the stationary that had been ordered. Payment was requested to be made by 11 January 2013 but the police department actually paid for the stationary by same-day bank transfer on 3 January 2013. The stationary order was delivered to the police department and signed as received on 28 December 2013.

The police department's financial year runs from 1 January to 31 December.

Compare how the police department would report the stationary order under:

a) Cash basis

b) Modified cash basis, with one month specified period

c) Accruals basis

5.3. Preparation of financial statements for public institutions

Learning Activity 5.3

Your District Accountant is hiring you to help him in closing the financial period due to the numerous activities to be done during a given period.

Required: Discuss any five financial statements that you will need to prepare for your District.

General guidance relating to preparation of financial statements

Financial statements must present fairly the financial position, financial performance and cash flows of an entity to ensure that the users of financial statements are provided with useful information for decision making purposes. The general qualitative characteristics of financial reporting are:

- **Understandability** – the information must be readily understandable to users of financial statements. This means that

information must be clearly presented, with additional information supplied in the supporting notes as needed to assist in clarification.

- **Relevance** – The information must be relevant to the needs of the users, which is the case when information influences the financial decisions of users. This may involve reporting particularly relevant information, or information whose omission or misstatement could influence the financial decisions of users.
- **Reliability** – The information must be free of material errors and bias, and not misleading. Thus, the information should faithfully represent transactions and other events, reflect the underlying substance of events, and prudently represent estimates and uncertainties through proper disclosure.
- **Comparability** – The information must be comparable to the financial information presented for other accounting periods, so that users can identify trends in the performance and financial position of the reporting entities.
- **Going concern assumption** – When preparing financial statements, a public entity is required to assess whether it can be assumed that it is able to continue as a going concern. Generally, financial statements of a public entity are prepared on going concern basis unless there is an intention to liquidate the entity or discontinue business or administrative operations or there is no alternative but to do so. Such uncertainties must be disclosed.
- **Consistency of presentation** – The presentation and classification of items in the financial statements must be consistent from one period to another unless required otherwise by a significant change in the nature of the entity's operations or a change in one or more IPSASs.
- **Materiality and aggregation** – Each material class of items in the financial statements must be presented separately. Aggregating items of a different nature or function is permitted only if they are immaterial individually.
- Offsetting – Assets and liabilities, and revenue and expenses, may not be offset.
- **Comparative information** – comparative prior period information must be presented for all amounts shown in the financial statements and notes to the extent relevant for understanding of the current period's financial statements

5.3.1. Statement of financial performance

Statement of performance is a financial report which shows revenues and expenditures.

The following illustrates the format of statement of performance:

Statement of Financial Performance

	Note	Year ended 30-Jun 2022	Year ended 30-Jun 2021
		RWF	RWF
Revenues			
Tax Revenue	01	X	X
Social contributions	02	X	X
Fines, penalties and forfeits	03	X	X
Grants	04	X	X
Transfers from other government entities	05	X	X
Revenue from exchange transactions	06	X	X
Other revenue	07	X	X
Borrowings	08	X	X
Total Revenue		**X**	**X**
Expenses			
Wages, Salaries and Employee Benefits	09	(X)	(X)
Goods and services	10	(X)	(X)
Capital expenditure	12	(X)	(X)
Depreciation and amortization expense	13	(X)	(X)
Finance costs	15	(X)	(X)
Subsidies	16	(X)	(X)
Grants and other transfer payments	17	(X)	(X)
Social assistance	18	(X)	(X)

	Note	Year ended 30-Jun 2022	Year ended 30-Jun 2021
		RWF	RWF
Other expenses	19	(X)	(X)
Repayment of borrowings	20	(X)	(X)
Benefits payments	21	(X)	(X)
Total Expenses		**(X)**	**(X)**
Other gains and losses			
Foreign exchange loss / (gain)	11	(X)/X	(X)/X
Impairment of property, plant, and equipment	14	(X)	(X)
Surplus / (Deficit) before income tax		**XX/(XX)**	**XX/(XX**
Income tax credit/ (expense)	22	X/(X)	X/(X)
Surplus / (Deficit) for the period		**XX/(XX)**	**XX/(XX**
Surplus / (Deficit) for the period is attributable to:			
Owners of the controlling entity	23	X/(X)	X/(X)
Non-controlling interests	24	X/(X)	X/(X)

Prepared by: **Insert the name of Accountant/Chief Accountant** __________ Signature __________ Date

Reviewed by: **Insert the name of Head of Finance** __________ Signature __________ Date

Checked by: **Insert the name of Head of Corporate Services**

______________________ ______________

Signature Date

Approved by: **Insert the name of Chief Budget Manager**

______________________ ______________

Signature Date

5.3.2. Statement of financial position

Statement of financial position is a statement showing at a given date, assets and liabilities of an entity.

The following illustrates the format of statement of financial position:

Statement of Financial Position

	Note	Year ended 30-Jun 2022	Year ended 30-Jun 2021
		RWF	RWF
ASSETS			
Current assets			
Cash and cash equivalents	25	X	X
Receivables from exchange transactions	26	X	X
Receivables from non-exchange transactions	27	X	X
Inventories	28	X	X
Prepayments and other current assets	29	X	X
Other financial assets	30	X	X
Total current assets			
Non-current assets			
Noncurrent receivables from exchange transactions	31	X	X

	Note	Year ended 30-Jun 2022	Year ended 30-Jun 2021
		RWF	RWF
Noncurrent receivables from non-exchange transactions	32	X	X
Deferred tax assets	33	X	X
Investments in associates and joint ventures	34	X	X
Biological assets	35	X	X
Investment property	36	X	X
Infrastructure, Plant and Equipment	37	X	X
Land and Buildings	38	X	X
Intangible assets	39	X	X
Total noncurrent assets			
Total Assets		**XX**	**XX**
NET ASSETS/EQUITY AND LIABILITIES			
Liabilities			
Current Liabilities			
Payables	40	X	X
Short-term borrowings	41	X	X
Deferred revenue	42	X	X
Current income tax	43	X	X
Other financial liabilities	44	X	X
Current portion of long-term borrowings	45	X	X
Employee and social benefits	46	X	X
Short-term provisions	47	X	X
Total current liabilities			
Non-current Liabilities			
Noncurrent payables from exchange transactions	48	X	X
Service concession liabilities	49	X	X
Deferred tax liabilities	50	X	X
Long-term borrowings	51	X	X

	Note	Year ended 30-Jun 2022	Year ended 30-Jun 2021
		RWF	RWF
Long-term provisions	52	X	X
Employee and social benefits	53	X	X
Total non-current liabilities		X	X
Total Liabilities		X	X
Net Assets/Equity			
Capital contributed by Other government entities	54	X	X
Reserves	55	X	X
Accumulated opening balances	56	X	X
Adjustments on cash and cash equivalents	57	X	X
Adjustments on Receivables	58	X	X
Adjustments on Inventory	59	X	X
Adjustments on non-current assets	60	X	X
Adjustments on current liabilities	61	X	X
Adjustments on noncurrent liabilities	62	X	X
Accumulated surplus/deficit	63	X	X
Non-controlling interest	64	X	X
		X	X
Total Net Assets/Equity		X	X
Total Liabilities and Net Assets/ Equity		**XX**	**XX**

Prepared by: **Insert the name of Accountant/Chief Accountant** ______ Signature ______ Date ______

Reviewed by: **Insert the name of Head of Finance** ______ Signature ______ Date ______

Checked by: **Insert the name of Head of Corporate Services** ______ Signature ______ Date ______

Approved by:	Insert the name of Chief Budget Manager	Signature	Date

5.3.3. Statement of cash flows

This statement shows, at a given date inflows and outflows of cash and cash equivalent.

Statement of Cash Flows

	Note	Year ended 30-Jun 2022	Year ended 30-Jun 2021
		RWF	RWF
Cash flow from operating activities			
Receipts			
Tax Revenue	01	X	X
Social contributions	02	X	X
Fines, penalties and forfeits	03	X	X
Grants	04	X	X
Transfers from other government entities	05	X	X
Revenue from exchange transactions	06	X	X
Other revenue	07	X	X
Borrowings	08	X	X
Total Revenue			
Payments			
Wages, Salaries and Employee Benefits	09	(X)	(X)
Use of goods and services	10	(X)	(X)
Foreign exchange loss /(gain)	11	(X)	(X)
Finance costs	15	(X)	(X)
Subsidies	16	(X)	(X)
Grants and other transfer payments	17	(X)	(X)
Social assistance	18	(X)	(X)
Other expenses	19	(X)	(X)
Repayment of borrowings	20	(X)	(X)
Benefits payments	21	(X)	(X)

	Note	Year ended 30-Jun 2022	Year ended 30-Jun 2021
		RWF	RWF
Adjusted for:			
Changes in inventory	66	X/(X)	X/(X)
Changes in receivables	67	X/(X)	X/(X)
Changes in payables	68	X/(X)	X/(X)
Prior adjustments	56-62	X/(X)	X/(X)
Net cash flows from operating activities	**A**	X/(X)	X/(X)
Cash flows from investing activities			
Biological assets	35	(X)	(X)
Investment property	36	(X)	(X)
Infrastructure, Plant and Equipment	37	(X)	(X)
Land and Buildings	38	(X)	(X)
Intangible assets	39	(X)	(X)
Purchase of controlled entity or other operating entity	34	(X)	(X)
Proceeds from sale of controlled entity or other operating entity	34	(X)	(X)
Proceeds from sale of Biological assets	35	(X)	(X)
Proceeds from sale of Investment property	36	(X)	(X)
Proceeds from sale of Infrastructure, Plant and Equipment	37	(X)	(X)
Proceeds from sale of Land and Buildings	38	(X)	(X)
Proceeds from sale of Intangible assets	39	(X)	(X)

	Note	Year ended 30-Jun 2022	Year ended 30-Jun 2021
		RWF	RWF
Purchase from foreign currency securities	30	(X)	(X)
Capital expenditure	12	(X)	(X)
Net cash flows from investing activities	**B**	X/(X)	X/(X)
Cash flow from financing activities			
Repayment of borrowings	45+51	(X)	(X)
Proceeds from borrowings	45+51	X	X
Net cash flow from financing activities	**C**	X/(X)	X/(X)
Net increase/(decrease) in cash and cash equivalents	**A+B+C**	X/(X)	X/(X)
Cash and cash equivalents at beginning of period		X	X
Effects of exchange rate changes on the balance of cash held in foreign currencies		X	X
Cash and cash equivalents at end of period		**XX**	**XX**

Prepared by: **Insert the name of Accountant/ Chief Accountant**

Signature Date

Reviewed by: **Insert the name of Head of Finance**

Signature Date

Checked by: **Insert the name of Head of Corporate Services**

Signature Date

Approved by: **Insert the name of Chief Budget Manager**

Signature Date

5.3.4. Statement of change in net assets

Statement of Changes in Net Assets/Equity

CHANGES IN NET ASSETS ITEMS	Notes	Accumulated surplus/ deficit 2020/2021	Movement during the year 2021/2022	Total 2019/2020
		RWF	RWF	RWF
CHANGES IN NET ASSETS				
Accumulated opening balance				
Accumulated opening balance	56			
Accumulated surplus from previous years				
Accumulated surplus/ (deficit)	63			
Accumulated adjustments				
Adjustments on cash and cash equivalents	57			
Adjustments on Receivables	58			
Adjustments on non-current assets	60			
Adjustments on current liabilities	61			
Accumulated opening balance				

CHANGES IN NET ASSETS ITEMS	Notes	Accumulated surplus/ deficit 2020/2021	Movement during the year 2021/2022	Total 2019/2020
		RWF	RWF	RWF
Accumulated opening balance	56			
Accumulated surplus from previous years				
Accumulated surplus/ (deficit)	63			
Accumulated adjustments				
Adjustments on cash and cash equivalents	57			
Adjustments on Receivables	58			
Adjustments on non-current assets	60			
Adjustments on current liabilities	61			

Prepared by: **Insert the name of Accountant/ Chief Accountant** ____________ Signature ____ Date

Reviewed by: **Insert the name of Head of Finance** ____________ Signature ____ Date

Checked by: **Insert the name of Head of Corporate Services** ____________ Signature ____ Date

Approved by: **Insert the name of Chief Budget Manager** ____________ Signature ____ Date

5.3.5. statement of Comparison of Budget and Actual Amounts

Statement of comparison of Budget and Actual Amounts

	Notes	Approved budget	Revised budget	Actual	Difference
		2022	2022	2022	2022
		RWF	RWF	RWF	RWF
Revenue					
Tax Revenue	01	X	X	X	X
Social contributions	02	X	X	X	X
Grants	04	X	X	X	X
Transfers from other Government Reporting entities	05	X	X	X	X
Other revenue	03 06 07	X	X	X	X
Expense					
Compensation of Employees	09	X	X	X	X
Use of Goods and Services	10	X	X	X	X
Subsidies	16	X	X	X	X
Finance cost	15	X	X	X	X
Grants and Transfers to other government entities	17	X	X	X	X
Social Benefits	18	X	X	X	X
Other expenses	19	X	X	X	X
Repayment of borrowings	20	X	X	X	X
Benefits payments	21	X	X	X	X
Operating balance		X	X	X	X

	Notes	Approved budget	Revised budget	Actual	Difference
		2022	2022	2022	2022
		RWF	RWF	RWF	RWF
Acquisition of non-financial assets	12	X	X	X	X
Disposal of non-financial assets	12	X	X	X	X
Net borrowing		X	X	X	X
TRANSACTIONS IN FINANCIAL ASSETS AND LIABILITIES (Financing)		X	X	X	X
Net Acquisition Of Financial Assets		X	X	X	X
NET INCURRENCE OF LIABILITIES		X	X	X	X
Borrowings - Domestic	08	X	X	X	X
Borrowings - External	08	X	X	X	X
Repayment of borrowings	20	X	X	X	X

Prepared by:	**Insert the name of Accountant/ Chief Accountant**	Signature	Date
Reviewed by:	**Insert the name of Head of Finance**	Signature	Date
Checked by:	**Insert the name of Head of Corporate Services**	Signature	Date
Approved by:	**Insert the name of Chief Budget Manager**	Signature	Date

The following notes and schedules should accompany a complete set of financial statements:

i. Accounting policies followed in the preparation of Financial Statements;

ii. Bank reconciliation statements and supporting copies of bank statements for entities;

iii. Petty cash account certificates;

iv. Detailed schedules of debtors and other receivables, creditors and other payables;

v. Summary of physical assets extracted and reconciled to the fixed assets register and summary of inventory;

vi. Summary of intangible assets;

vii. Summary of investments made by the entity to date;

viii. Summary of consumable inventory;

ix. Summary of contingent liabilities;

x. Trial balance;

xi. A statement showing the purposes of implementation of audit recommendations; and

xii. Any other schedule that will enhance easy understanding of the financial statements.

Application activity 5.3

Identify the key users of the financial statements for a public entity and consider their information needs.

5.4. Government budget in accordance with the requirements of IPSAS24

Learning Activity 5.4

Mr GATERA criticized the annual government budget prepared advancing the reason that an annual budget is short sighted, he was provided with long –term government programs that cover several years and he also found them to have a long-term perspective such that there is another tool necessary to link the budget to such long-term program.

Required:

a) As an accountant, who understands the budgeting process in Rwanda, identify for Mr GATERA, a tool used in planning and budget process that can serve as a link between annual budget and long-term government programs and briefly explain how the tool works.

b) Explain the objectives of the tool used in planning and budget process that can serve a link between annual budget and long-term government programs.

5.4.1. Government budgeting

A budget is a quantitative expression of a plan of action prepared in advance of the period to which it relates to. Budgets set out the costs and revenues that are expected to be incurred or earned in future periods.

Purposes of budgeting

Planning for the future, in line with the objectives of the organization

Evaluation: To judge managerial performance.

Controlling costs: To compare with actual results to enable investigations into significant differences.

Coordination of different activities to ensure goal congruence

Authorization of expenditures

Motivation of managers by encouraging them to beat targets set at the beginning of the budget period. Bonuses are often based on beating budgets.

Communication: Budgets communicate the targets of the organization to individual managers.

Budgeting in Public Sector

- Budgeting and financial management are at the core of economic and public sector reform programs in most nations around the world. With the growing pressures for enhanced service delivery and the challenges of budgetary crises and fiscal shocks, the need for improved budget processes and innovative financial management techniques is especially critical in developing and emerging economies.

To the government, budget usually serves as:

- An estimate of revenue and expenditure for a given fiscal year;
- A guide towards the execution of the year's activities; and
- An instrument of evaluating performance.

Based on the information above, **budget in the public sector is normally used as an effective instrument for the following.**

- As an instrument for economic policy
- Instrument for effective management
- Instrument for evaluating performance

Approaches to Budgeting

- Traditional or Incremental Based Budgeting
- Zero Based Budgeting
- Program and Planning Based Budgeting
- Performance Based Budgeting

5.4.2. International Public Sector Accounting Standards (IPSAS)

The IPSASB develops and publishes the IPSAS. Now, the IPSASB aim to develop high quality accounting standards to support public sector entities to prepare general purpose financial reporting and improve the quality and transparency of financial reporting in the public sector.

Many IPSAS are based on the International Financial Reporting Standards (IFRS) or the former International Accounting Standards (IAS) which tend to

be adopted in the private sector.

The following table illustrates IPSAS and corresponding IFRS. IPSAS continue to be published. However, as at June 2019 the following are in publication

IPSAS Reference	IPSAS Title	Corresponding IFRS	Main difference (s) with corresponding IFRS
IPSAS 1	Presentation of Financial statements	IAS 1	– Including public guidance and terminology – Requires a statement showing all changes in net assets/equity – Does not specifically preclude the presentation of revenue and expense items as extraordinary
IPSAS 2	Cash flow statements	IAS 7	– Uses different terminology and definitions – Encourages reconciliation of surplus/deficit to operating cash flows in the notes to the financial statements
IPSAS 3	Accounting Policies, changes in Accounting Estimates and errors	IAS 8	– Does not require disclosures about adjustments to basic or diluted earnings to per share. – Uses different terminology

IPSAS Reference	IPSAS Title	Corresponding IFRS	Main difference (s) with corresponding IFRS
IPSAS 4	The effects of changes in foreign exchange	IAS 21	– Uses different terminology
IPSAS 5	Borrowing Costs	IAS 23	– Uses different terminology
IPSAS 6	Consolidated and separate Financial statements	IAS 27	– Not relevant as IPSAS has been superseded
IPSAS 7	Investment in Associates	IAS 28	– Not relevant as IPSAS has been superseded
IPSAS 8	Interests in joint ventures	IAS 31	– Not relevant as IPSAS has been superseded
IPSAS 9	Revenue from Exchange transaction	IAS 18	– Title refers to exchange transactions rather than simply revenue – Uses different terminology.
IPSAS 10	Financial reporting in hyper inflationary Economies	IAS 29	– Does not include guidance on the restatement of current financial statements. – Uses different terminology
IPSAS 11	Construction Contracts	IAS 11	– Includes binding arrangements that are not a legal contract – Includes non cost and non-commercial contracts – Uses different terminology

IPSAS Reference	IPSAS Title	Corresponding IFRS	Main difference (s) with corresponding IFRS
IPSAS 12	Inventories	IAS 2	– Requires inventories that are acquired through a non –exchange transaction to be recorded at their fair value as at the date of acquisition – Requires inventories that are provided at no charge or nominal charge to be valued at the lower of cost and current replacement cost – Uses different terminology
IPSAS 13	Leases	IAS 17	– Includes additional implementation guidance to illustrate lease classification, finance lease treatment by lessee and lesser, and calculation of interest implicit in a finance lease. – Uses different terminology

IPSAS Reference	IPSAS Title	Corresponding IFRS	Main difference (s) with corresponding IFRS
IPSAS 14	Events after reporting date	IAS 10	– Has a different title – Where the going concern assumption is no longer appropriate, judgment is required to determine the impact on the carrying value of assets and liabilities recognized in the financial statements – Uses different terminology
IPSAS 15	Financial Instruments: Disclosure and presentation	IAS 32	– No relevant as IPSAS has been superseded.
IPSAS 16	Investment property	IAS 40	– Requires investment property to be measured at cost and specifies that where an asset is acquired for no coast or nominal costs, its fair value as at the date of acquisition should be used as its cost – Uses different terminology

IPSAS Reference	IPSAS Title	Corresponding IFRS	Main difference (s) with corresponding IFRS
IPSAS 17	Property, plant and equipment	IAS 16	– Where an item is acquired at no cost or for a nominal cost, its cost should be its fair value as at acquisition date – Uses different terminology class of asset basis – Revaluation increases and decreases are offset on
IPSAS 18	Segment Reporting	IAS 14	– Different definition of segments – Does not require segment result to be disclosed. – Encourages disclosure of significant non cash revenues included in segment revenue, segment depreciation or non cash expenses or segment cash flows. – Uses different terminology

IPSAS Reference	IPSAS Title	Corresponding IFRS	Main difference (s) with corresponding IFRS
IPSAS 19	Provisions, contingent liabilities and contingent assets	IAS 37	– Does not apply to provisions or contingent liabilities from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods and services provided directly in return from recipients of those benefits. – If the entity chooses to recognize provisions for social benefits, certain disclosures are required.
IPSAS 20	Related party Disclosures	IAS 24	– Has different scope and structure. – Uses different terminology.
IPSAS 21	Impairment of non-cash generating Assets	None	– Deals with the impairment of non-cash generating assets rather than cash generating assets – Uses different terminology

IPSAS Reference	IPSAS Title	Corresponding IFRS	Main difference (s) with corresponding IFRS
IPSAS 22	Disclosure of financial information about General Government Sector	None	– Not applicable as not based on an equivalent IFRS
IPSAS 23	Revenue from Non-exchange Transactions (taxes and transfers)	None	– Not applicable as not based an equivalent IFRS
IPSAS 24	Presentation of Budget information in Financial statements	None	– Not applicable as not based on an equivalent IFRS
IPSAS 25	Employee Benefits	IAS 19	– Not relevant as IPSAS has been superseded
IPSAS 26	Impairment of cash generating assets	IAS 36	– A forced sale is not considered a reflection of fair value less costs to sell – Includes requirements and guidance on the re-designation of assets between cash generating and non-cash generating assets – Uses different terminology

IPSAS Reference	IPSAS Title	Corresponding IFRS	Main difference (s) with corresponding IFRS
IPSAS 27	Agriculture	IAS 41	– Agricultural activity definition includes transactions for distribution of biological assets at no charge or a nominal amount – Does not cover biological assets held for provision or supply of services – Includes requirements for the measurement of biological assets acquired through a non-exchange transaction at initial recognition and at each reporting date. – Uses different terminology.
IPSAS 28	Financial Instruments: presentation	IAS 32	– Includes additional guidance on when assets and liabilities from non-exchange revenue transactions are financial assets or financial liabilities – Includes additional guidance on identifying arrangements that are contractual in substance. – Uses different terminology

IPSAS Reference	IPSAS Title	Corresponding IFRS	Main difference (s) with corresponding IFRS
IPSAS 29	Financial Instruments: recognition and measurement	IPSAS 36	– Includes additional guidance for concessionary loans and financial guarantee contracts entered into are zero or minimal consideration – Uses different terminology
IPSAS 30	Financial Instruments: disclosures	IFRS 7	– Includes requirements regarding concessionary loans – Uses different terminology.
IPSAS 31	Intangible Assets	IAS 38	– Specifically excludes powers and rights conferred by legislation, constitution or equivalent. – Does not require or prohibit the recognition of intangible heritage assets – Uses different terminology.
IPSAS 32	Service Concession Arrangements-Grantor	IFRIC 12	– Applies to the grantor, while IFRIC 12 is applied to the operator. – Uses different terminology
IPSAS 33	First-time Adoption of accrual basis IPSASs	IFRS 1	– Different structure and requirements – Uses different terminology

IPSAS Reference	IPSAS Title	Corresponding IFRS	Main difference (s) with corresponding IFRS
IPSAS 34	Separate Financial Statements	IAS 27	– Includes specific requirements for a controlling entity that is not an investment entity itself but has an investment in a controlled investment entity. – Uses different terminology
IPSAS 35	Consolidated Financial statements	IFRS 10	– Includes additional guidance on non-financial benefits – Defines binding arrangement – Does not require a controlling entity that is not an investment entity to consolidate all controlled entities – Uses different terminology

IPSAS Reference	IPSAS Title	Corresponding IFRS	Main difference (s) with corresponding IFRS
IPSAS 36	Investments in associates and joint ventures	IAS 28	– Applies to all investments where the investor has a quantifiable ownership interest. – Allows an entity that is precluded by IPSAS 29 from measuring retained interest in former associate or joint venture at fair value, to use carrying amount as the cost on initial recognition of the financial asset. – Uses different terminology.
IPSAS 37	Joint Arrangements	IFRS 11	– Defines binding arrangement. – Includes additional illustrative examples reflecting the public sector – Uses different terminology

IPSAS Reference	IPSAS Title	Corresponding IFRS	Main difference (s) with corresponding IFRS
IPSAS 38	Disclosure of Interests in Other Entities	IFRS 12	– Structured entity definition incorporates alternative ways control may be obtained in the public sector. – Requires a controlling entity that controls an investment entity, but is not an investment entity itself, to disclose information regarding unconsolidated investment entities. – Uses different terminology
IPSAS 39	Employee benefits	IAS 19	– Includes guidance on public sector bonus plans. – Entities apply a rate that reflects the time value of money – Uses different terminology
IPSAS 40	Public sector combinations	IFRS 3	– Has different structure and scope. – Certain combinations are classified as amalgamations. – Includes additional guidance on transactions specific to the public sector, such as tax forgiveness. – Uses different terminology.

IPSAS Reference	IPSAS Title	Corresponding IFRS	Main difference (s) with corresponding IFRS
IPSAS 41	Financial statements	IFRS 9	– Does not distinguish between revenue and income – Includes additional guidance on how to apply requirements regarding concessionary loans, certain financial guarantee contracts and fair value measurement. – Some use of different terminology, such as statement of financial performance (not statement of comprehensive income or separate income statement) and net assets/equity (rather than equity).
IPSAS 42	Social benefits	None	– Not applicable as not based on an equivalent IFRS
Cash basis IPSAS	Cash flow statements	None	– Not applicable as not based on an equivalent IFRS

As you can see from the table above, many of the IPSAS use different terminology to the IAS or IFRS on which they are based. This is perhaps unsurprising as the nature of public sector entities also differ.

You may have also noticed that the final entry in the table is the Cash Basis IPSAS. It is worth highlighting that all other IPSAS are based on the accrual method of

accounting which reflects the IPSASB's preference for accrual based reporting. Indeed, one of the aims of the IPSASB is to move public sector organizations from the cash to the accruals basis of accounting and even the cash basis IPSAS is intended to be a stepping stone towards achieving accruals reporting.

Application activity 5.4

The budget officer of the Ministry of Health is preparing a consolidated budget for the financial year 2021/2022. During that exercise one of its budget including the following items:

	Item description	Amount in RWF
1	Laboratory equipment	300,000,000
2	Medical staff salaries	100,000,000
3	Office building	1,000,000,000
4	Electricity bills	50,000,000
5	Training of medical staff	25,000,000
6	Office supplies	25,000,000

Required:

a) Differentiate recurrent from development budgets

b) Classify the above provided items under recurrent and development budget

Skills Lab 1

With the teacher, students carry a visit to nearest Public sector entity. They ask for some books of accounts held by the entity and available financial statements for previous years from the Accountant officer. They observe, and share findings thereafter.

End unit assessment 5

1. The Government of Rwanda adopted the use of IFMIS as an information management tool. The benefits of using IFMIS include**:**

   i. Enabling government reform and improving efficiency and controls

   ii. Improving confidence through transparency

   A. (i) only

   B. (i) & (ii) only

   C. (i), (ii) & (iii)

   D. (ii) & (iii) only

2. A government that follows full IPSAS accrual must present a statement of financial position that complies with IPSAS for the line items presented**. The IPSAS that guide the presentation of property, plant and Equipment is:**

   A. IPSAS 16

   B. 1PSAS 1

   C. IPSAS 19

   D. None of the above

3. One of the important Public Financial Management (PFM) reforms that the government of Rwanda has put in place is the use of Integrated Financial Management Information System (IFMIS). The implementation of IFMIS came with a lot of benefits but it also presents certain risks which include but not limited to lack of capacity, weak commitment to change and technical challenges.

Required:

Explain any Five (5) internal controls that can be put in place to minimize these risks associated with the use of IFMIS

Unit 6 INTRODUCTION TO COMPANY ACCOUNTS

Key unit competence : To be able to prepare books of accounts for a limited Liability company

Introductory activity

Company accounts analyses Company financial activities over a period of 12 Months. They are prepared and maintained for every period to show the Company's performance and its assets against liabilities. Unlike sole proprietorship or Partnerships, Company accounts records amounts from shares, debentures etc.

From the knowledge acquired from the previous subjects, what do you think is the distinction between, a sole proprietorship, Partnership from Company accounts?

6.1. Introduction to limited liability Company

Learning Activity 6.1

Sole proprietorship, partnership differs from companies in terms of the size and the share capital.

1. What are the benefits of forming companies?

6.1.1. Company as corporate legal body

A **company** is a legal entity formed by a group of individuals to engage in and operate a commercial business. Similarly, **a company is described** as a voluntary association of persons who have come together for carrying on business and sharing the profits. **Members of the company** work together with the same goal to accomplish particular goal. The members of the Company are called Shareholders. They are called **shareholders** because they bought shares.

Being considered a legal entity in the terms of the law, companies are able to enter into contracts, hold and dispose of property, raise capital through the issuance of shares, etc. The members of a company enjoy a separate and distinct existence from members. Unlike single traders/ sole proprietorships, and partnerships. The company business pays off its liabilities and debt.

According to Rwanda's Law Governing Companies 17/2018, company accounts must be filed three months after the year's end. They frequently include specific guidelines on the minimal data that must be included in a company's financial statements. Non-incorporated enterprises, often known as unlimited liability companies, frequently experience relative freedom from statutory regulation.

Companies are classified into two namely ;

1. Limited liability Company
2. Unlimited liability Company.

1. Limited liability Company

What is a limited liability Company ?

A limited company is **a company limited by shares** *or* a limited liability Company is form of company where the shareholders are only limited by their

shares.

Limited liability means that a company's owners or investors are only liable for the total amount of money (in form of shares) they have invested in the business. The shareholders of the business will be protected in the case of bankruptcy if it is registered as a limited liability company. Furthermore «limited liability» will imply that the owner's losses are only restricted to the proportion of their specific share and that they are not liable for losses that exceed their shares. In this case, if the company suffers losses or goes Bankrupt, they cannot attack their own properties.

2. Unlimited liability

Unlimited liability is the opposite of limited liability. Unlimited liability means that if the company incurs debts that it is unable to pay, the owners will be held personally accountable for the unpaid debts and may be required to sell their personal properties in order to pay back the debts.

Characteristics of limited Companies

1. All members have a limited liability
2. They have a separate legal existence
3. The debts of the company are separate from those of the shareholders
4. Shareholders are not liable for the day to day activities of the business
5. It can carry out any activity as long as it does not go against the law.

Advantages of Companies

- Shareholders enjoy limited liability
- Larger capital is raised through larger membership
- Risk of fraud is minimized because their accounts are audited annually.
- They are more permanent in nature because the death or retirement of a
- Shareholder does not affect the company.
- Companies can easily access funds from financial institutions.
- Companies operate in legal frame work-companies Act.

Disadvantages of companies

- They pay formation and registration costs
- Burden of taxes : companies pay corporation tax.

- The shares of a company are scattered and the transferability of the shares
- Kills the morale of the shareholders and when the morale is down, the affairs of the company are not considered which gives chance to managers to promote their own interests.
- Companies are difficult to form because they have to produce a number of documents and have to follow legal procedures before they are formed.
- If profits are made, they are reduced as they have to be shared among shareholders.

6.1.2. Difference between Sole trader, Partnership and Limited Company.

Sole trading	Partnership	Limited Company
– Is a business formed and run by one person with the purpose of making profits (individually)	– Partnerships allow two or more people to set up in business together, sharing the risks, the work to make profits	– is formed by buying shares
– Soletraders are personally reliable for the debts of the business. **For example,** if a sole trader has some capital in their business, but the business now owes RWF 2 million which it cannot repay, the trader might have to sell their house to raise the money to pay off their business debts.	– Debts of the business are unlimited. **For example**, if a partnership has failed to pay their creditors who supplied them. The partners are obliged to pay using their own properties or resources.	– Debts and the liabilities are limited to company shares. **For example,** in case a company is not able to pay its debts let say a bank loan. Shareholders loss will only be limited to their share capital.
– Profits are shared by one person (the owner)	– profits are share among members of the partnership	– Profits are shared by shareholders in form of dividends

Sole trading	Partnership	Limited Company
– A sole trader is responsible for all that is done in the business/there is no shared responsibility	– Responsibility is shared among partners	– The day to day activities of the company business is done by the directors
– is not separate from the owners (sole trader)	– is not separate from the owners (partners)	– - Is a separate entity separate from its owners (shareholders)

Formation of registration of companies in Rwanda :

A company is formed by incorporation. Incorporation is done by :

- Filling appropriate forms for Memorandum of association and may have also
- Articles of association given to registrar of companies with appropriate fees and a certificate of incorporation is issued.

Memorandum of association is a document that shows the relationship between the company and the outsiders. It contains the following ;

- The name and address of the company,
- The objectives of the company, showing whether it is :
    - Limited or unlimited
    - Private or public and the authorized share capital

Articles of association shows the rules and regulations for the company internal structure.

It contains items like :

- The number of directors,
- When the annual general meetings are to be held.
- The voting rights of the shareholders,
- Dividends policy, and
- Other rules.

NOTE : It is a pre-requisite for companies to prepare Articles and Memorandum of Association and get them notarized by a Public Notary. One copy is retained at the Notary's Office, one at the Registrar General's Office at RDB and one at the Office of the Official Gazette for publication.

Certificate of incorporation

A certificate of incorporation is obtained at the Company registry at RDB upon submitting an application letter addressed to the Registrar General, a receipt of registration fees payable at the National Bank of Rwanda and three copies of the articles and memorandum of Association

Establishing a subsidiary/branch

Foreign companies wishing to establish a branch or a subsidiary company in Rwanda apply to the Minister of Trade and Industry for authorization to establish a branch and the Registrar General of RDB for registration in the registry of companies. RDB is the principal Government Agency responsible for facilitating investors to realize their investment projects in Rwanda

They must present a board resolution/declaration of the company to invest in Rwanda, articles and memorandum of association of the parent company and certificate of incorporation.

6.1.3. Shares and share capital

Definition of shares

A share is a unit of Capital to a company. It is the interest a shareholder or owner has in a company. Memorandum of association (company constitution) must statea fixed amount of a share.

Types of shares

Shares are broadly divided into two;

- Ordinary shares
- Preference shares.

Ordinary shares

Ordinary shares are those shares which do not carry a fixed rate of dividends and the dividend rate depends on amount of profits and directors` decisions. Ordinary dividends are paid after tax and after full payment of preference dividends. The holders of ordinary shares are called ordinary shareholders and they are paid ordinary dividends out the profits make by company business.

Ordinary shares are considered as risk takers as they get their dividends after the full payment of the preference dividends. However, they are able to use their rights to manage the firm’s affairs by voting at meetings of the company.

Preference shares

Preference shares right a fixed rate of dividends out of profits distributed for any year and their holders claim first their dividends before ordinary shares. Ordinary dividends cannot be paid before preference shareholders are paid in full. The holders of preference shares are called preference shareholders and are entitled to preference dividends out of the profits made by the company business. In the event of a company's liquidation, preference shareholders will have priority over ordinary shareholders in receiving their capital back. Preference shareholders do not carry a voting right.

Types of preference shares

Cumulative preference shares: These shares entitle their holders to a fixed rate of dividend. If there are not sufficient profits to pay this fixed rate in a particular year, arrears will be paid in the following year or at a first opportunity when profits are made.

Non-cumulative preference shares: These also claim a fixed rate of dividend and if there are not sufficient profits to pay in a particular year their holders do not claim arrears in the following year.

Example Dividends on ordinary shares and preference shares

UMUCYO Ltd has issued 50, 000,000 ordinary shares of RWF500 each and 20,000,000 7% preference shares of RWF100 each. Its profits after taxation for the year to 30 September 20X5 were RWF840 million. The management board has decided to pay an ordinary dividend (ie a dividend on ordinary shares) which is 50% of profits after tax and preference dividend.

Required

Show the amount in total of dividends and of retained profits, and calculate the dividend per share on Ordinary shares.

Answer :

RWFm

Profit after tax 840

Preference dividend (7% of RWF100 u 20, 000,000) 140

Earnings (profit after tax and preference dividend) 700

Ordinary dividend (50% of earnings) 350

Retained earnings (also 50% of earnings) 350

The ordinary dividend is RWF7 per share (RWF350 million by 50 million ordinary shares).

The appropriation of profit would be as follows :

RWFm	**RWFm**
Profit after tax	840
Dividends : preference	140
Ordinary	350
	490
Retained earnings	350

As we will see later, appropriations of profit do not appear in the statement of profit or loss, but are shown as movements on reserves.

Share capital of the company

Share capital is the amount of money a company raises by selling shares to public and private sources or investors.

The company act provides that the Memorandum of association must state the amount of share capital with which the company has to register and the division of the share capital into shares of a fixed amount.

The share capital of the company forms the permanent fund in the company and is reported in the balance sheet.

The investor will then pay for and be issued with the shares and therefore, they become owners. Each share has a flat value called Par value/face value/ nominal value.

Example 1

For example, if a company decides to set up a share capital of RWF 200,000, it may decide to issue :

200,000 shares of RWF1 each per value. (200,000 x 1=200,000RWF)

100,000 shares of RWF 2 each per value. (100,000 x 2= 200,000RWF)

400,000 shares of RWF 0.50 each per value. (400,000 x 0.50=200,000RWF)

Forms of share capital:

The capital of the company is called share capital because it consists of or raised by selling shares. The following are forms of share capital:

1. **Authorized or registered share capital or nominal capital:** This is the maximum amount as stated in the memorandum of association, a company may raise by selling shares.

For example

If a company wishes to sell 1,000 shares of RWF1,000 each, its authorized share capital is RWF. 1,000,000

i.e number of shares *price of the share=1,000*1,000=RWF. 1,000,000

2. **Issued share capital:** This is the value of the shares that have been issued whether or not the full amount against them has been called up. It is also called **Subscribed capital**

For example

If the above company has issued 600 shares for sale, the issued share capital would be RWF. 600,000.

i.e number of shares *price of the share=600*1000=RWF600,000

3. **Called up share capital:** This is the amount that the shareholders have been asked to pay. When shares are issued or allotted, a company does not always expect to bepaid the full amount for the shares at once. It might instead call up only a part of the issue price, and wait until a later time before it calls up the remainder.

e.g. if the above company has asked its shareholders to pay only 600 RWF per share, it's called up share capital would be 600*600 =360,000RWF.

4. **Uncalled up share capital:** This is the total amount which is to be received in future, but which has not been asked for. 600*400=240,000RWF.

5. **Paid up share capital:** This is the amount that has actually been received from the shareholders. Like everyone else, investors are not always prompt or reliable payers. When capital is called up, some shareholders might delay their payment (or even default on payment). Paid-up capital is the amount of called-up capital that has been paid.

e.g. in the above case shareholders holding 50 shares have failed to pay a call of 200RWF per share, the paid up would be;

Called up	360,000
Less: arrears	10,000
Paid up capital	350,000

6. **Calls in arrears:** This is total amount which has been asked i.e. (called for) but has not yet been paid by shareholders. 50*200=10,000 RWF

7. **Minimum share capital:** This is the amount stated by the promoters when making application for registration of the company as the minimum required amount to commence trading effectively.

Application activity 6.1

1. What is a share?
2. What is the difference between ordinary and preference shares?

6.2. Accounting and adjustments of shares

Learning Activity 6.2

A company ABC wishes to issue shares as per stated in its memorandum of Association. The members only know about the market value of shares and they do not know about other relevant information. They need you as a professional accountant to give you some clarification such as:

a) Distinguish between a share issues at par, an issue at premium, at a discount

b) The market value of a share is irrelevant to the company when preparing its financial statements.' Discuss this statement'

6.2.1. Stages on issue of shares

When the company has been registered the following stages should be taken for the company to be able to collect money from the public by issuing shares :

1. **Prospectus.**

When a public company plans to raise capital by selling shares to the general public. A copy of prospectus asks the public to submit an offer to purchase company share on or before the date of publication and this copy must be sent

to the registrar of businesses for registration.

It must provide a summary/information of the business, its track/past record, and the project that the company is issuing shares for. It also includes the starting and the closing date of the issue of shares, application fee, at the time of allotment and on calls, name of the Bank for application fee deposit, accepted minimum number of shares to be issued etc.

2. Application

After the public have finished reading and they are satisfied, they can apply to the company for the purchase of shares on the printed subscribed form. After, the public sends an application form together with the application money to specified bank account and receives a receipt. The application money cannot be withdrawn by the company until the allotment is done.

3. Allotment

Company shares are issued on the understanding that they are payable by installments and the following points would be considered;

That when the public apply for shares, they send a sum of money known as the application money. This is not a guarantee that they will receive shares and this money can always be refunded to the applicants. At this stage the directors will send what is known as allotment letters to the successful applicants. These letters reflect the acceptance of the allotment of shares and the binding contract now exists between the company and the subscriber.

Finally, the applications and the allotment account must only remain with the right nominal value expected on application and allotment. The amounts in these accounts is transferred to shareholder's share capital account.

Accounting entries made

There are two methods by which accounting entries are made on application and allotment :

Method 1

In this first method, application and allotment account should be treated separately. In this case the application account records, the application money and allotment account records the money (share capital) from the allotted shares.

Application account

Dr			Cr
Bal b/d	XXX	Bal c/d	XXX

Allotment account

Dr			Cr
Bal b/d	XXX	Bal c/d	XXX

Dr **Share capital account**

Bal C/d	**XXX**	**Application &allotment XXX**

Method 2 :

Here both the application and the allotment account are treated the same and the accounting entries are the following ;

1. Application money received :
   - Debit : Bank account
   - Credit : Application and allotment account
2. Application money refund to unsuccessful applicants :
   - Debit : Application and allotment account
   - Credit : Bank account
3. On allotment of shares
   - Debit : Application and allotment account
   - Credit : share capital account
4. Allotment money received :
   - Bank account
   - Credit : Applicant and allotment account

Example

ABC ltd issued 1,000 ordinary shares each at RWF100, payable on the following conditions ;

- RWF.40 on application
- RWF. 60 on allotment

Applications received were 1,200 shares. On 2nd March, allotment was done and the excess applicant were returned to the unsuccessful applicants.

Required: Show the journal entries and ledger a/cs to record the above transactions and extract a balance sheet at 31th March 2021, assuming that the sums of money were received in due time.

ABC LTD

I. The Journal

		RWF	RWF
1	Bank account	48,000	
	Application and allotment		48,000
	i.e application money for 1,200 shares issued @ RWF. 40 per share)		
2	Application and allotment	8,000	
	Bank account		8,000
3	Application and allotment	100,000	
	Share capital		100,000
	i.e (application and allotment money as decided by the directors is transferred to share capital i.e 1,000 shares, each at RWF. 100)		
4	Bank account	60,000	
	Application and allotment		60,000
	i.e (allotment money of 1,000 shares issued, each at RWF. 60 received)		

II. The ledger

Dr **Bank account** **Cr**

	RWF		RWF
Application &allotment	48,000	Application and allotment	8.000
Application and allotment	60,000	Balance c/d	100,000
	108,000		**108,000**

Dr **Application and allotment** **Cr**

	RWF		RWF
Bank account	8,000	Bank account	48,000
Ordinary share capital	100,000	Bank account (allotment)	60,000
	108,000		**108,000**

Dr **Ordinary share capital** **Cr**

	RWF		RWF
Balance c/d	100,000	Application and allotment	100,000
	100,000		**100,000**

6.2.2. Issue of shares

On market shares are sold on the following conditions :

1. **At par/nominal value** : This is where a share is issue at the price that is stated in the memorandum of association of a Company.
2. **At premium** : This is where on the market the share is issued at price above par value of nominal value. In this case a share is issue at a premium and the amount of the shares is called **share premium.** If a company issue shares at a premium, they need to open a separate account called share premium account that appears in the credit side of the balance sheet.
3. **At discount** : This is where shares are issued at a price lower than the price that is stated in the memorandum of association of the Company.

Share premium:

The amount at which the shares are issued may exceed their par value. Premium means additional cash due to the difference between the issue price of the share and its par value.

When a company is first set up the issue price of its shares will probably be the same as their par value and so there would be no share premium. If the company does well, the market value of its shares will increase, but not the par value. The price of any new shares issued will be approximately their market value.

For example, 1 : A company might issue 100,000 shares of RWF100 at a price of RWF120 each. Subscribers will then pay a total of RWF12, 000,000. The issued share capital of the company would be shown in its accounts at par value, RWF10, 000,000. The excess of RWF2, 000,000 is described not as share capital, but as **share premium or capital paid-up in excess of par value.**

Example 2. The difference between cash received by the company and the par value of the new shares issued is transferred to the share premium account.

i.e if Umucyo Ltd issues 1,000 RWF100 ordinary shares at RWF260 each the book entry will be :

	RWF	RWF
DEBIT ; Cash	260,000	
CREDIT : Ordinary shares		100,000
Share premium account		160,000

A share premium account is an account into which sums received as payment for shares in excess of their nominal value must be placed.

Once established, the share premium account constitutes capital of the company which cannot be paid out in dividends, i.e it is a capital reserve. The share premium account will increase in value if and when new shares are issued at a price above their par-value. The share premium account can be 'used' – and so decrease in value – only in certain very limited ways, which are largely beyond the scope of yourbasic financial accounting syllabus. One common use of the share premium account, however, is to'finance' the issue of bonus shares. Other uses of this account may depend on national legislation.

The reason for creating such non-distributable reserves is to maintain the capital of the company. This capital 'base' provides some security for the company's creditors, bearing in mind that the liability of shareholders is limited in the event that the company cannot repay its debts. It would be most unjust – and illegal – for a company to pay its shareholders a dividend out of its base capital when it is not even able to pay back its debts.

Example Share issue

AB Co issues 5, 000,00 at 500RWF for 6, 000RWF million. What are the entries for share capital and share premium in the statement of financial position ?

Share capital	Share premium
A. 5,000 RWF million	1,000 RWF million
B. 1,000 RWF million	5,000 RWF million
C. 3,500 RWF million	3,500 RWF million
D.2, 500 RWF million	3,500 RWF million

Solution

Price per share is 500 RWF each (ie par value/face value /nominal value) and shares were issued at 1,200RWF each (ie RWF 6,000m/5 shares). Of this, 500 RWF is the price of the share capital and 700 RWF is share premium price.

Therefore, option D is the correct answer.

6.2.3. Under and Over subscription of shares

Under Subscription is defined as the situation where the number of shares applied by the public is less than the shares that are issued by the company. Companies that have just started or lack a good reputation will experience under-subscription.

Oversubscription is defined as the situation where a company receives more applications from share buyers than the number of shares made available for the public. In simpler terms, oversubscription happens when the demand for shares exceeds the supply. Oversubscription does not always guarantee a company's success, since projected success must happen in order for shares to remain in high demand.

Differences between under and over subscription

Under subscription	Over subscription
the number of shares applied by the public is less then the shares that are issued by the company Full allotment made i.e all the applications for the shares are accepted Issued capital is more than the subscribed capital There will be no need for refund No pro-rata allotment in case of under subscription of shares	A company receives more applications from share buyers than the number of shares made available for the public. All the applications won't be approved and the shares will be allocated on a pro-rata basis Issued capital and subscribed capital are equal in number Money is refunded in case the application is rejected Pro-rata allotment is made by issuing shares to all applicants on proportional basis.

Let's consider a situation where MBC directors allot to applicants only a fraction of shares applied for. Following such kind of allotment, the company is required to refund the applicant money for the fraction of shares that are not allotted. On the hand, the applicants once allotted some shares, become liable for payment of the required balance on their allotted shares. Other than refund, the company therefore retains the un-used applicant money to make payment against the allotment money when it becomes due.

The following are the accounting entries ;

i. **On application** : record the total value of the application money received

ii. **On allotment** : successful applicants (applicants who receive a fraction of shares applied for) will pay allotment money.

Example : MBC ltd. Company offered 100,000 ordinary shares each of 10RWF at a premium of 2 RWF payable in installments.

i. On application	3RWF
ii. ON allotment (including premium)	7RWF
iii. On first call and final	2RWF
	12 RWF

Applicants received 130,000shares and the allotment was done as follows ;

Applicants for 80,000 shares- full shares allotted

Applicants for 40,000shares - 20,000 shares allotted

Applicants for 100,000 shares - rejected

Excess application money for partially accepted applicants is to be used to reduce the amount due on allotment. All money due on allotment and first and final call was received expect 6,000 shares allotted to Mugabo, who failed to pay for the first and final call.

Workings

a) Application money received : 130,000 shares *3 RWF=390,000 RWF,

The number of shares offered are 100,000 less than number of shares applied for thus ; there is going to be a refund to unsuccessful applicants ie

b) Application refund=30,000 shares*3RWF=6,000 RWF

c) Total value payable on application and allotment=100,000shares *8RWF=800,000 RWF

d) Excess on application ; 40.000shares applied were allotted 20,000 shares ie20, 000shares *3=60,000RWF

e) Premium cash/money=10,000 shares *2RWF=20,000RWF

f) Received on allotment including premium=allotment due (including premium) - Excess application :

100,000shares *7 RWF= 700,000

Less : Excess application= 60,000

640,000

g) Money received on first and final call

94,000 shares *2 RWF= 188,000 RWF

h) Calls in arrears =6,000*2=12,000RWF

6.2.4 Forfeiture and reissue of forfeited shares

Forfeiture of shares refers to the cancellation of shares allotted to the shareholders for non-payment.

There are instances in business where a stakeholder loses their share due to non-payment of their financial liability of installments or dues. The only way a company can forfeit a share is if the firm's articles of association permit it.

Also, Shareholders whose shares are forfeited lose their shareholder rights and interests as well as their membership in the organization.

A person whose shares have been forfeited ceases to be a member in respect of the forfeited shares but remain liable to pay the company all the monies which at the time of forfeit, were payable. To record forfeit of shares, open a forfeited shares account. The total nominal value of the shares forfeited is credited to this account and debited to share capital account. The amount unpaid on the shares in arrears account and debited to the forfeited shares account.

Example

UWUNO Co. Ltd have an authorized capital 1.000,000 RWF divided into 20,000 ordinary shares of 50 RWF issued and fully paid except 200 shares held of MUCYO on which only 5,000RWF has been paid.

Following many reminders and demands for payment, the board of directors made a decision to forfeit the shares held by MUCYO.

Required :

Show the journal entries in the company's journal and ledger recording the forfeiture of shares.

Solution

Journal entries

	Dr	Cr
Ordinary share capital account	10,000	
Forfeited shares account		10,000
(200 ordinary shares of RWF 50 each forfeited		
For non-payment of call as per resolution of directors)		
Forfeit shares account	5,000	
Calls in arrears account		5,000
(Calls in arrears RWF 25 per share on 200		
Ordinary shares forfeited)		

Dr **Ordinary share capital account** **cr**

	RWF		
Forfeit shares	10,000	**Bal b/f**	**1,000,000**
Balance c/f	990,000		
	1,000,000		**1,000,000**

Dr **Calls in arrears account** **cr**

	RWF		RWF
Balance b/f	5,000	Forfeited shares account	5,000

Dr **Forfeited shares account** **Cr**

	RWF		RWF
calls in arrears account	5,000	**Ordinary share capital account**	**10,000**
Balance c/f	5,000		**10,000**
	10,000		

Re-issue of forfeited shares

If shares are forfeited the membership of the shareholder stands cancelled and the shares become the property of the company. Thereafter, the company has an option of selling such forfeited shares. The sale of forfeited shares is called **'reissue of shares'**

Therefore, re-issue of shares is the selling of forfeited shares. When re-issuing shares the new purchaser must be pay the shares at the nominal value. if shares are re-issued at the value above the nominal value, the surplus should go to share capital account and the following are the necessary accounting entries;

1. Debit : forfeited shares re-issued account

Credit : Share capital account

(With nominal value of shares re-issued)

2. Debit : Forfeited shares account

Credit : forfeited shares re-issued account

(With amount received before to forfeiture in respect of shares re-issued)

3. Debit : Bank account

Credit : Forfeited shares re-issued account

(With amount received on re-issue of forfeited shares)

4. Debit : Forfeited shares re-issued account

Credit : Shares premium account

(With the balancing figure on the forfeited shares re-issued account)

Example

UCOMO Company ltd issued 3,000 ordinary shares of RWF10 at RWF 120 each as shown below ;

On application RWF 3

On allotment RWF 5 (including premium)

On first and final call RWF 4

Applications were received and the allotment was med to successful applicants. All the installments were paid expect the first and final call of RWF for 1,000 shares held by MUHIMA whose shares were forfeited on 10th August 2021 and re-issued on 19th September 2021each at RWF 8.

Required :

Show the following accounts as they appear in the ledger

i. Forfeited share account

ii. Forfeited shares re-issued account

NOTE : Ignore completing double entry in the rest of the accounts

Dr **Forfeited shares account** **Cr**

2021		RWF	**2021**		**FR**
August 10	calls in arrears	4,000	**August 10**	**Share capital**	**10,000**
September 19	forfeited re-issued	6,000			
		10,000			**10,000**

Dr **Forfeited shares re-issue** **cr**

2021		RWF	2021		RWF
September 28	share capital	10,000	September 19	forfeit shares	6,000
September 28	share premium	4,000		Bank	8,000
		14,000			14,000

Working ;

i. Calls in arrears forfeited =1,000 shares *RWF 4=RWF4, 000

ii. Amount received before forfeiture

Application 1,000 shares *RWF 3=RWF 3,000

Allotment 1,000 shares * RWF3=RWF 6,000

iii. Amount received on re-issue=1,000 shares *RWF 8=RWF8, 000

iv. Nominal value of re-issued shares=1,000shares*RWF 10=RWF10, 000

v. Share premium on re-issue =1,000 shares*RWF2=RWF12, 000

Application activity 6.2

1. A company issues five million RWF100 shares at a price of RWF125 per share. How much should be posted to the share premium account?

   A. RWF 5 million
   B. RWF 1.25 million
   C. RWF 6.25 million
   D. RWF 6 million

5. KAMANI co.ltd has the authorized share, 500,000 @ 120RWF per share, and shares issued were 380,000. The company asked shareholders to pay 100RWF per share who actually paid 80RWF per share.

Required:

Calculate for the following;

i. Authorized share capital

ii. Issued share capital

iii. Called up share capital

iv. Uncalled share capital

v. Paid-up share capital

End unit assessment 6

1. UTC Ltd. Co.ltd issues 100000 equity shares of face value of 100 RWF on 1st June 2018 at 20% premium. The arrangements for payment are:

June 1, 2018: On Application 20RWF

July 1, 2018: On Allotment including Premium 70RWF

September 1, 2018: On First and final call 30RWF

The company receives applications for 285000 shares. This is a case of oversubscription. It deals with them in the following manner:

1. Applicants for 25000 shares receive a full allotment.
2. The applicants for 225000 shares receive one share for every three shares applied for on pro-rata basis.
3. It rejects the applications for 35000 shares.

The company duly receives the entire amount. Pass necessary journal entries.

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