TOPIC 1

THE ROLE OF GOVERNMENT IN PROMOTING TRADE IN MALAWI

1. It develops and makes the tourism industry attractive. It does by constructing more hostels, making national roads accessible, legislating laws that aim at conserving the natural resources, promoting cultural preservation and ensuring efficient communication network system.
2. It manages and conserves the fishing industry. This is done by;
3. encouraging people to use recommended nets,
4. using quota system,
5. civic education on the dangers of overfishing
6. Creating fish ponds.
7. Setting fort rules for trade aimed at ensuring fair trade so that neither buyers nor suppliers are exploited.
8. Checking out monopolies by opening out the economy to outside investors. It can also do this by privatizing state owned industries.
9. Ensuring the efficient public services and structure. These services must include telecommunication, police, fire protection, roads etc.
10. Maintaining economic growth by adopting fiscal and monetary policies that will direct to a conducive economic environment.

Roles of local government in promoting trade

1. Providing licenses to people wishing to open up businesses such as rest houses or bottle stores in cities or districts.
2. Ensuring security at local levels in collaborating with the police and neighborhood watch groups.
3. Improving local assembly infrastructure such as roads for efficient transport network system.
4. Providing fire extinguishing services in case some businesses catch fire.
5. Constructing several flea markets in various convenient places in towns or cities to promote trade

Roles played by Malawi government to promote trade through

Ministry of Commerce , Trade Industry

1. It issues both wholesale and retail licenses to people who like to venture into businesses.
2. It registers various businesses through Registrar of companies.
3. It regulates the activities of all financial lending institutions such as Malawi Rural Finance Company, SEDOM etc.
4. It ensures even distribution of essential commodities such as sugar, salt and maize.
5. It gives information on export and import procedures
6. It appoints trade consuls to protect the interest of Malawian traders in foreign countries.

b. Malawi Bureau Standards (MBS)

- It ensures that producers meet the required standards in products
- It is mandated to test imports and exports in order to control their quality through their testing laboratories.

S. R. Kabanga

Elements that have to be fulfilled to make trade liberalization to be complete and become effective

1. **Profitability-** people must make profit on what they offer for sale.
2. **Risk reduction-** there must be minimal level risks to promote good businesses.
3. **Economic freedom-** sellers and buyers must exercise their freedom on the products
4. **The market-** there must be conducive market for n good business
5. **Competition-** competition must exist in order to improve quality of products.
6. **Government intervention-** there must be minimal government intervention to control trade

Advantages and disadvantages of trade liberalization

Advantages

- It promotes the faster growth of private enterprise than public sector
- Business community is free to trade in the way they want so as to make them better off
- Due to little government involvement in one's business, it makes him to have power over his products.
- It promotes competition thereby leading in the production of quality products
- It encourages more foreign investors to come to Malawi

Disadvantages

- Freedom of trade leads to consumer exploitation through high prices
- A country with low production level becomes an importing country.
- It makes Malawi to become a dumping area for the rejected goods in other countries.
- It leads to the closure of domestic industries and being replaced by foreign industries
- It makes Malawi to lose some reasonable revenues through tax since the foreign industries are given 5 years holiday as tax free- period.

ECONOMIC INTEGRATION

It is an economic treaty or alliance adopted by countries to have common, fiscal and monetary policies hence they decisions that are made are followed by each member state.

Forms of economic integration

1. **Preferential Trade Area-** This is where nations agree and sign a common memorandum of understanding where custom duties are reduced on imports and exports moving within the trading bloc. Its aims are to increase the volume of trade within the member states.
2. **Free Trade Area**—this trading bloc where nations agree on completely abolishing all the custom duties on imports and exports moving within it.
3. **Free Trade Area is also called Free Trade.** Free trade is the trade where imports and exports attract zero custom duties.

4. **Customs Union-** This is where the member states set up or establish a common tariff of duties on goods imported from non-member states but with free trade or zero custom duties within the union.

Economic union

It is a well-established and organized form of economic integration formed by a group of nations who agree to adopt similar economic, fiscal and monetary plus political and technological policies within its bloc. An example is the European Union.

Common markets

These are markets that share exactly or approximately the same laws and principles of trading. The nations in the common market only agree to follow the same policies, rules and regulations on trade but do not create a custom union; neither do achieve a complete free trade area. Examples of common markets are EU, AGOA, ECOWAS, SADC, and COMESA

SOUTHERN AFRICA DEVELOPMENT COMMUNITY-SADC

Southern Africa Development Community was established in 1992.

The member states of SADC included the following

Angola	Zimbabwe	Mauritius
Botswana	Zambia	Mozambique
DRC	Mozambique	Malawi
Lesotho	Namibia	Seychelles
South Africa	Tanzania	

a. **The Southern African Development Community(SADC)**

SADC is comprised of countries from southern Africa.

Its aims/objectives are

- To consolidate development strategies within the region
- To make a full common utilization of resources and markets with the whole are
- To increase income and employment opportunities within the region
- To foster the effort of achieving free trade are by starting with the adoption of preferential custom duties within the SADC.

b. **Common Market For East And Southern Africa(COMESA)**

COMESA was established after it was ratified by the member states on 8th December, 1994 in Lilongwe, Malawi replacing the Preferential Trade area (PTA) for Eastern and Southern African states which was established in 1981.

Reasons/Objectives for the Formation of THE COMESA

1. To share the region's common heritage and destiny
2. To ensure greater social and economic cooperation
3. To create regional economic community.
4. Work towards achieving common policies in judicial and banking systems
5. Facilitate the free flow of goods, services and labour within the region
6. Work towards achieving freer trade area with zero custom duties.

Member States of COMESA

These include Angola, Burundi, Comoros, DRC, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe.

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c **European Union (EU)**

It aims at

- Creating a single wider and broader market for the facilitation of the flow of capital goods
- Co-ordinating the banking systems by creating an European Monetary Bank
- Creating a European Central Bank to manage their single currency, the EURO.
- Promoting the cross boarder investments within the member states.

d. **African Growth and Opportunity (AGOA)**

Its aims are

- To provide African countries an opportunity to export goods into the US on duty free and quota free basis.
- To assist American industries to access markets in Africa and establish trade partners with African firms
- To improve accessibility of African nations to United States' technical expertise.

e. **ECONOMIC COMMUNITY OF WEST AFRICAN STATES (ECOWAS)**

Its aims are

- To work towards achieving a free trade area through eliminating trade barriers within the region
- To create a common rate of custom duties to be charged on imports from non-member nations
- To increase labour mobility within member states
- To facilitates common policies in financial resources and agriculture.

TRADE PROTOCOL

It is a code of conduct or agreement made between or among individuals or nations on how to trade with one another. It involves removing trade barriers such as tariffs, quotas or using a common currency etc.

Types of trade protocol

a. **Unilateral Trade Protocol**

It is the trade protocol signed by two nations but only one nation benefits from the agreement.it exits between one developed nation and the other developing country.

b. **Bilateral Trade Protocol**

It is an agreement made between two countries only and both nations have mutual benefit.

Advantages

- It enhances fairly perfect comparative advantages
- It reduces boarder tariffs and interest rates

- It helps to build relationships between the two countries
- Two countries become one global market

Disadvantages

- It limits the number of goods and services to be transacted
- Perfect comparative advantages may lead to dumping
- It may lead to the collapsing of infant industries due to strong foreign competition.
- Political unrest in one country may affect other's economy.

c. **Multilateral Trade Protocol**

This is the trade agreement whereby more than two countries are involved

Advantages

- It may lead to wide range of goods/services to be transacted
- It enhances perfect comparative advantages
- Political unrest in one country may not necessarily affect al countries involved.

Disadvantages

- Comparative advantages may lead to dumping of goods
- Infant industries may be closed down by strong competition from strong foreign industries.
- It becomes less interesting to travel abroad for more business when there is one global marketing.

TRADE GLOBALISATION

Globalization is the process of opening up the whole world such that companies, nations, firms and industries should easily access the large global markets.

Factors that encourage trade globalization in Malawi

1. Improved communication facilities such as introduction of computers, cell phones and television equipment has helped a lot
2. High education levels. Well educated people have access to global information through internet and other modern equipment.
3. Status-quo and prestige – some people are only interested to get international standard products just to make a difference with others.
4. High quality products- the whole world has become one village whereby business man can choose from where to obtain the product needed.
5. The cost of transportation has fallen which increase the interaction between trading partners and transportation of goods has become cheaper.

Advantages/importance and disadvantages of trade globalization

Advantages

- It leads to economies of scale and greater efficiency where companies source and supply goods on a global basis
- Everyone gains access to cheaper gods and services
- The whole world becomes one global village
- Less developed countries gain access to world markets.

- Stiff completion leads to high quality products to be produced by firms
- It makes companies to make huge profits due to large world market share.

Disadvantages

- The less developed countries become the victim of dumping
- The world becomes a less interesting place as the same goods are supplied to most markets of the world.
- Transport costs are high when there is globalization .
- Companies need to spend a lot on international products and research

TOPIC 2: STATUTORY CORPORATIONS

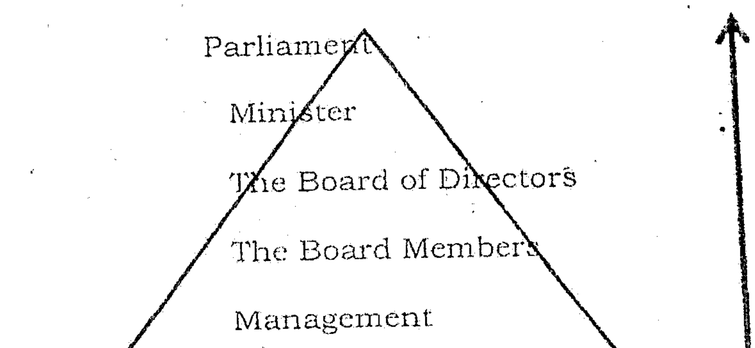
It is any public organization which is either directly or indirectly owned by the government for purposes of providing services to the general public or aid the government in revenue collection.

Formation of statutory corporation

It is formed by the Act of Parliament and assented to by the State President.

Describe the hierarchy of statutory corporation

The management reports to Board Members and this report to Board of Directors who in turn report to the responsible Minister who then becomes answerable to the Parliament. The hierarchy for parastatal or statutory corporation is shown below



Objectives or reasons why statutory corporations are formed

1. **Commercially oriented-** Some are formed to make profits for the government. They generate funds for the government to cover its expenses and meet its budget requirements.
   Examples are include ADMARC, ESCOM, Water Boards, MRA, MHC etc.
2. **Service providers-** some are established to provide services to the general public. Examples include MBC, University of Malawi, National Library etc.

The types of statutory corporations

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Major features of statutory corporations

1. **Formation and ownership**
   Public enterprises are formed by the Act of Parliament and assented by the State President.
   They are owned by the government.
2. **Management and control**
   They are managed and controlled by the Board of Directors appointed by the State President to run the day to day activities of the business and are chosen on trust and accountable to Parliament through Public Accounts Committee.
3. **Capital and profits**
   Capital- Capital for public enterprises is obtained from the government through borrowing it from elsewhere or they borrow money from Treasury to finance their projects.
4. **Profits-** Profits made by public enterprises is used to pay loans obtained, to provide services to the general public or it is ploughed back into the business. Losses incurred by the public enterprise are usually met by taxpayers through Treasury.

Advantages and disadvantages of statutory corporation

Advantages

- Essential services and goods are provided to the general public cheaply and on a more comprehensive scale.
- Corporations are not area-selective
- It leads to decentralization hence sectors become effective on services they offer
- Due to decentralization, sectors can afford to pay good remuneration to their workers.

Disadvantages

- They encourage monopoly of trade e.g. ESCOM
- There are a lot failures to meet public demand.
- Work is not seriously done due lack of control by management
- Too much corruption by workers when discharging their duties that they are monthly paid for.
- There is rampant pilferage in public enterprise especially by junior workers.

TOPIC 3: PRIVATISATION/DENATIONALIZATION

- It is the act of removing ownership and control from the government to individuals by offering them shares on Malawi stock exchange.
- It is also defined as the transfer of industry from state ownership to private ownership.

Duties /objectives of the Privatization Commission/Public-Private Commission

1. It assumes the de-facto interim ownership of the on-going privatized enterprises for the duration of transition.
2. It carries out any preparation of the public enterprises to become private enterprise where necessary.
3. It formulates and recommends to cabinet for the approval of the preferred privatization option.
4. It implements the divestment in accordance with the approved privatization methodology.

Reasons/objectives for denationalization or why the government privatized its nationalized industries in Malawi

- To increase revenue for the government through earning corporate tax
- To foster increased efficiency in the economy by selling state owned companies which are inefficient.
- To reduce government borrowing since the government would stop when the state owned companies are privatized.
- To reduce monopoly in the economy
- To promote participation by the Malawian public in businesses
- To promote free market system so that the economic activities is regulated by the common man,

Examples of privatized industries in Malawi

Some of the privatized industries in Malawi include Agrimal MW company, Packaging Industries, SUCOMA, Mchenga Coal Mines, Soche Tours, Kasungu Inn, NICO ltd, Optichem MW Ltd, Portland Cement Company Ltd.

Forms of privatization in Malawi

1. **Offer of share to public**- the state owned companies offer shares to the public so that ownership of the company moves from the public to the private sector.
2. **Deregulation of industries**- this allows private firms to compete against state owned businesses where they could not have done before.
3. **Contracting out of work to private firms**-this form serves to give out work that was previously done by the government to private sector.
4. **Public private partnership**- this is where the government invites the private sectors to run certain industries in association.

Discuss the advantages and disadvantages of privatization.

Advantages/benefits

1. it results into efficient use of resources since production of goods and services is challenged by competition
2. It helps the government to collect revenue in the form of tax from the privatized industries
3. It leads to free market economy it helps to improve the standard of living to those Malawians that acquire shares in the privatized industries.
4. It helps to keep government expenditure low
5. It helps companies to produce high quality products to meet international standard due to competition.

Disadvantages/problems

1. It leads to private monopoly and ownership and this makes the owners of the privatized industry to charge their prices more than in the hands of the state.
2. It leads tom job losses since privatization of the public enterprise is followed by redundancy.
3. It encourages capitalism, a situation where the poor continue to be poor and those who are richer continue to be rich.
4. It leads to financial base whereby the government is left by the dormant industries and all profitable companies are privatized.
5. It leads to capital fright, a situation whereby foreign investors take money away from Malawi to their country.
6. It leads to social cost. The privatized industries do not consider the welfare of the society in terms of pollution.
7. The government may lose revenue through privatization since future profits will not go to the Treasury but the few individuals owning the business.
8. The government may privatize a public enterprise cheaply.
9. The government may privatize a public enterprise which provides essential services.

TOPIC 4: INSURANCE

Insurance refers to the cover to protect businesses or individuals against both external and internal events leading to business loss.
In other words refers to the sharing of the loss of the few, between or among the many

Terms as used in insurance

- **Insurer-** This refers to the insurance company that provides protection to the insured in return for the premium that he pays to the insurer. In other words, insurer is the insurance company that provides insurance policies.
- **Insured-** this refers to the customer seeking protection against financial loss from insurable risks from the insurer. In other words, insured is the client/business that buys insurance policies.
- **Insurance policy document-**This is a document that indicates an agreement between the insured and the insurance company stating the premium to be paid and the sum of money the insurance company promises to compensate the insured in time of need.
- **Insurance policy-** this refers to the agreement or insurance contract and its details.
- **Premium- It** refers to the fixed sum of money that the insured is required to pay to the insurance company so as to service the insurance policy to make it valid. In other words, premiums refer to periodic or annual payments that the insured pays to the insurance company.
- **Proposal form-** It refers to the document on which written information about the insured is collected and the calculation of premium is based on the data contained on it.
- **Cover note-** It is a temporary document which is given to the insured and it acts a proof of insurance before insurance policy is issued.

- **Risks-** Risks are basically dangers or misfortunes that occur in the course of running the business.
- **Claim form-** It is a written document which has to be submitted by the beneficiary to the insurer to get the payment against the financial loss.
- **Accessor/actuaries-** It is somebody employed by an insurance company to assess risks and fix premiums.
- **Insurance brokers/underwriters-** these are agents who sell insurance policies on behalf of insurance companies they are working for. They guide clients on polices that benefit them. They travel short and long distances in search for clients.

Types of insurance risk and the business risks that affect businesses in Malawi

1. **Insurable risks –** These are risks that the total loss from the event occurred can fairly be estimated accurately in advance and are the ones that are covered by the insurance companies.
   Examples of insurable risks are **fire on the house, road accident on a vehicle, theft on a car, death on a person** etc.
2. **Non insurable risks** – these are risks which cannot be estimated and reasonably be measured even by past experience. They are not covered by the insurance companies.
   Examples of non insurable risks include **effects of war, unforeseen changes in fashion resulting in loss of business, street riots, vandalisms by vendors, lava eruption in Malawi.**

The purpose/advantages of insurance in businesses

- It provides cover for the loss or provides protection against losses from insurable risks.
- Insurance brings foreign exchange to the nation mainly where there are included in the invisible export trade.
- It promotes the nation's economy because institutional investors invest pension money in a wide range of projects.
- Insurance may replace the responsibility of the parents when they are dead or become incapacitated.
- Policy holders may use it as collateral to make borrowings from the bank
- It helps a lot in reducing unemployment levels because the insurance companies employ a lot of Malawians.

Explain how does pooling of risk operate in insurance.

It states that the insured whether individuals or businesses contribute money in a certain patterns to the insurance company(common fund) from which compensation is made whenever one of the insured is involved in the financial losses caused by insurable risks.

Institutions that provide insurance services in Malawi

These include

- National Insurance Company

- Vanguard Insurance Company
- Old Mutual Mw Ltd
- United General Insurance
- Royal Insurance
- Prime Insurance

The main insurance principles

1. **Insurable interest** – This principle states that if the insured wants to be covered from a loss against fire on his house, then he must develop an interest based on house versus fire and nothing else. The house by be his own house and somebody's house.
2. **Utmost god faith/uberrimae fidei**- This principle states that the insured and the insurer must act in good faith to each other by disclosing fully any information that might affect the policy. This means that the insured must tell the insurer about anything that is more likely to affect the risk whether asked or not. He must disclose any possible information that can affect the contract honestly. Similarly, the insurer must disclose all the terms and conditions attached to the contract to avoid the insured being deceived.
3. **Indemnity**- This principle restores or brings back the insured to the position he or she was before the insured risk took place so that he/she neither makes a profit nor loss.
4. **Doctrine of proximate cause**- This state that there must be closes connection between the loss and the risk for which the policy was bought. For example, if the house was being insured against fire and destroyed by earthquake, then it cannot be compensated.
5. **Doctrine of Subrogation** – By this principle, the insured who has been compensated surrenders his right to claim and in case of motor car insurance any money raised from the sale of the wrecked car belongs to the insurance company.
6. **Contribution** – The principle states that if the insured insures his risk with two different insurance companies, it determines that each insurance company must partly contribute to the compensation so that no profit is made by the insured.

   Example

   Tayamba Building Company has a factory worth K10, 000,000 and insures it for K15, 000,000 with NICO and K5, 000,000 with Prime Insurance against fire. If the factory is completely destroyed by fire, how much will each company contribute to compensate the loss?

   Workings

   Factory Value =K10, 000,000
   NICO'S Risk = K15, 000,000
   Prime Insurance's Risk = K5,000,000
   Total Risk = K15,000,000+ K5,000,000
   = K20,000,000

   Payment by NICO =K15, 000,000 x $\frac{K10,000,000}{K20,000,000}$

= K7,500,000

Payment by Prime = K5, 000,000 x $\frac{K10,000,000}{K20,000,000}$

= K2, 500,000

Four types of insurance policies in Malawi

1. **Marine insurance**– it is insurance on the ship, cargo or any water accident. The following are the policies under marine insurance
   a. **Freight note**
      This is where cargo ship deals with charges for carrying cargo such as goods on water transport
   b. **Hull**
      This includes machinery damage or total loss by either storm or any other perils at sea. Sea perils include piracy,, earthquakes, storms, sinking, fire and jettisoning.
   c. **Cargo**
      It refers to the movement of goods exported to or imported from other countries.
   d. **Ship owner liability**
      It includes compensation for the passengers, cargo, crew etc that can be damaged by the actions of the ship itself.
   e. **Floating policy**
      It describes the insurance in general terms and leaves the name of ship well defined by subsequent declaration.

   Types of marine losses

   The following are the two types of marine losses
   a. **Total loss**
      It may either be
      - **Actual loss**
        This occurs when the subject matter is irretrievably destroyed and has become irretrievably lost.
      - **Constructive loss**
        This occurs when the subject matter is abandoned because its actual loss appears to be inevitable e.g. A wreck or where the cost of preventing actual loss would exceed the value of property when repaired such as sunken ship.
   b. **Partial loss/Average loses**
      These may either
      - **Particular average Loss**
        This is due to purely accidental loss hence concerns only the owners of the affected property.
      - **General Average Loss**
        This is one that is voluntarily incurred for the common good. It includes not only the actual loss but also any expenditure reasonably incurred in an attempt to avert danger or minimize loss.
2. **Life assurance** – This is used when the event that is insured against will definitely happen.

Features of life insurance

f. **Profits**

It issued either for profit motive which are calculated as per the sum assured using Simple Bonus Method or. Under Compound Bonus Method.

g. **Premium rate**

The premiums are payable yearly at uniform rates fixed or graduated according to age at entry and predetermined by reference to mortality rates.

h. **Surrender values**

The conditions of life policies provide for payments to persons who surrender their policies of a portion of the premiums paid in percentage repayments progressively increase with respect to the life of the policy.

Advantages of life Insurance

- Protection of dependents of the assured against his premature death
- Provision for old age when the assured can maintain his standard of living without substantial savings.
- Promotion of thrift where the assured has to pay premiums to keep the policy and he cannot get back the premium.
- It is used to obtain funds for investment
- It provides social security since it enables a person to provide for education and marriage of children and construction of houses.
- It can be used as collateral to raise loans.

The types of life assurance

a. **Endowment policy**-this policy allows the assured to pay premium for the agreed period of time. When the policy matures, the assured enjoys the benefits of the policy. When the assured dies before the policy matures, the sum assured is given to the next of kin.

b. **Whole life policy**-this policy allows the policy holder to be paying premium for the rest of his/her life and compensation is calculated at death of life assured. Under this policy gives out the names of next of kin who will act as beneficially for the policy when the policy holder dies.

c. **Annuity policy** - this policy is for pension scheme arrangement and allows the policy holder to pay premiums until he/she retires. The annuitant receives monthly compensation for the rest of his/her life until death.

d. **Education policy**- this is policy bought by parents for education of their children. It allows the insurance company to pay school fees for their children in case they die or become incapacitated

3. **Fire insurance**- This provides cover to persons against injuries whenever their properties are burnt injuries.

The following are fire policies

a. **Specific policy**

Under this policy the insurer undertakes to pay or make good to the insured actual loss or damage by fire caused to the insured property subject to the amount of the sum insured.

The actual value of the property is not taken into consideration while determining the amount of indemnity. Such a policy is not subject to average clause. **For instance, if a property worth K50 Million is insured for K30Million and a loss of K20 Million occurs, the insured will get K20 Million.**

b. **Average clause**

This policy contains an average clause which says that in case the property is under-insured (the sum insured is less than the value of property), the insurer will bear only that portion of the actual loss which the amount of the policy bears to the value of the property.

Claim for the actual loss = $\frac{Sum\ assured}{Value\ of\ property}$

Example

Mr Banda insured his house against fire for K2, 000,000 in 2010 and the value destroyed by fire in 2011 was K1, 000,000 and the market value of the house in that year was found to be K4, 000,000. How much would the insurance company pay?

Workings

Compensation = $\frac{Sum\ assured}{Value\ of\ property}$ x claim for the actual loss

= $\frac{K2{,}000{,}000}{K4{,}000{,}000}$ x K1,000,000

= K500,000

c. **Floating policy**

This is taken to cover goods belonging to the same person but lying in different lots at different places under a single sum and for one premium.

d. **Comprehensive policy/all insurance policy**

It is one which covers not only risk of fire but also of explosion, lighting, thunder, rebellion, riot, civil strife, insurrection etc. It is commonly taken by institutions like banks and factories as a requirement for registration.

4. **Motor Accident insurance**- This type of insurance covers up financial losses arising from various natures of accidents and injuries.

It is insured against the following risks

- Loss or damage to the motor vehicle after an accident or theft.
- Personal injury or death of the owner or passenger of the vehicle due to accident
- Damages payable to third parties by the owner of the vehicle for accidents.

It has the following policies

a. **Third Party Policy**

This is where every motor vehicle driver must be insured for unlimited sum against liability for death or injury to third person. First person is the owner, the second is the insurance company and the third person is the affected person. It is not the owner who compensates the injured person but the company.

b. **Comprehensive Motor Car Policy**

This policy covers all risks that the insurer will take as per those listed in that policy. It covers all damages to a third party e.g passengers, third party vehicles plus those to the insured vehicle, personal injury top the driver or any loss or damage to personal possession while in the damaged car. It covers all risks associated with the insured vehicle hence assumes higher premiums than third party policy.

c. **Fidelity Guarantee Policy**

This is used where a person is appointed to a position of trust which gives him the opportunity to embezzle any funds accrued from the policy. It gives the employer the right to claim from the damaged and stolen property on time of accident.

Insurance fraud

Insurance fraud occurs when one party knowingly lies in order to obtain some benefits or advantage of which they are not legally entitled. It may be done by the insurance company. They capitalize on the ignorance of the party concerned, for example the insurance company may twist some information in order to deny some benefits what is due and to which someone is entitled.

- **Types of insurance frauds**

2. **Medical insurance fraud**
   - This involves making suspicious claims by policy holders
   - The pharmacists inflating bills or falsifying billing. Some people obtain medical prescriptions and submitting them for habitual needs illegally.
   - Dental office inflating bills.
3. **Life insurance frauds**
   - Some policy holders make questionable death or staged death.
   - Some policy holders make false application relating to insured death in order to obtain monetary gain from life insurance policy
4. **Workers insurance compensation frauds**

- This involves claimant fraud, some employers committing illegal act against employees
- It involves medical providers inflating billing
- Some employers misclassify the type of workers to obtain worker's compensation coverage at a lower premium.
- Some employers misrepresent payroll to obtain worker's compensation at a lower premium
- Some employers embezzle funds for employees.

5. **Health care insurance frauds**

- It involves embezzlement of funds, making false identity to secure health care
- It involves recruiting patients and given incentives to undergo medical procedures whether those procedures were performed or not.it involves falsifying bills by medical providers for immunization that was never given.
- It involves pharmacy inflating bills or falsifies codes.

6. **Property Insurance frauds**

- It involves making suspicious residential theft.
- It involves theft commercial carrier that is insured reports cargo lost by commercial carrier.

- It involves vandalism to the interior or exterior of business or residence.
- It involves property theft from vehicle while it is stored in in a vehicle home.

7. **Fire insurance frauds**

- It involves making commercial fire.
- It involves making arson for hire where fire resulting from a hire person.
- It involves making suspicious residential fire damage.
- Some policy holders inflate claims from fire loss.

8. **Motor vehicle insurance frauds.**

- It involves faking damages on vehicles.
- It involves inflating damages to the vehicle exaggerated nonexistent.
- It involves vehicle theft or motor home theft.
- It involves vehicle arson.
- It involves auto property vandalism.

Risk management and risk management strategies in businesses

Risk management is s structured and coherent approach to identifying, assessing and managing business risk.

Objectives of risk management

a. **Compliance**

   This is to ensure compliance with applicable rules and regulations.

b. **Assurance**

   The interested parties in the business need to be sure that the company is complying with risk management and internal control.

c. **Decision making**

   Risk management activities should ensure that appropriate information on risks is available to support decision making.

WAYS OF MANAGING RISK

The risk can be managed by

1. **Hedging** – Hedging means efforts which businesses or individuals do to get protected from acts that cause financial loss.
2. **Risk management strategies which involves**
   d. Tolerating risk and its likely impact.
   e. Treating by reducing the likely impact.
   f. Transferring risk to another party
   g. Terminating which involves making activity that generate risk

THE WAYS OF HEDGING AGAINST THE RISKS

1. **Contingency plan-** It gives businesses alternatives in advance if unfavorable circumstances will appear. It gives ready provisional solutions in case the current plan will turn out to be false.
2. **Business continuity-** This means allowing business to continue to trade despite disasters or risks occurring provided that they are well hedged.
3. **Spot rate**

   This is where you buy the currency from the 'live market' at a specific moment in time and pay for it at that time. The longer you give yourself to arrange your currency transfer, the more likely you will get the best deal as you can wait for the best time to buy.

This involves training and supervision to enforce procedures; and providing personal protective equipment and improved welfare facilities.

b. **Control for fraud risk**
This involves making accessible detailed written system and procedures: and training to ensure understanding of procedures.

4. **Detective techniques**
These are designed to identify occasions when undesirable outcomes have been realized.

TOPIC 6: PRODUCTION COST

Production costs

Production costs refer to the total value of economic factors/input such as land, labour, capital that must be incurred to bring a product to its final stage-distribution stage.

In other words, production cost is the amount of money that is spent in order to produce a product.

TYPES OF INPUTS IN PRODUCTION

These include

1. **Fixed inputs-** There are economic factors that remain constant for given set of business activities e.g. rental fee
2. **Variable inputs-** these are economic factors that change following the changes in the level of business activities.

THE TYPES OF PRODUCTION COSTS

These are

1. **Fixed costs-** Fixed costs are the type of production cost that remains constant regardless of the increase in the level of business activities/output within a given period of time. Fixed cost must be incurred even if production output is zero. Examples are rental fees for lease, interest payable on loans, insurance premium.
2. **Variable costs–** Variable costs are those costs in a cost function that change with respect to rate of change of the firm's output. These may include wages; agricultural inputs such as pesticides, fertilizer etc.
3. **Total costs-** Total costs refer to the combination of fixed costs and variable costs in a given period of time.

The table below shows the total cost, total fixed costs , total variable costs, total revenue and total net profit or total loss made in the Month of ecemer, 2020.

Output	Sales	Variable Costs	Fixed Costs	Total Costs	Profit
'000	£'000	£'000	£'000	£'000	£'000
0	0	0	40	40	-40
1	10	4	40	44	-34
2	20	8	40	48	-28
3	30	12	40	52	-22
4	40	16	40	56	-16
5	50	20	40	60	-10
6	60	24	40	64	-4
7	70	28	40	68	2
8	80	32	40	72	8
9	90	36	40	76	14
10	100	40	40	80	20

Difference between economies of scale & diseconomies of scale

- **Economies of scale** refers to the rate of savings in terms of the cost of producing each unit of production as a result of increasing in size.

Advantages of economies of scale

a. **Technical economies-** a firm is able to use plants carrying specialist labour and machinery than small firms
b. **They enjoy financial economies-** large firm go direct to the money markets much easier.
c. **They have buying economies-** large companies enjoy quantity discounts due to bulk buying.
d. **The risk- bearing-** large firms are able to diversify and therefore able to sell products to different markets.

- **Diseconomies of scale-** this is when the increase in the scale of production of the firm causes decrease in the revenue per unit output

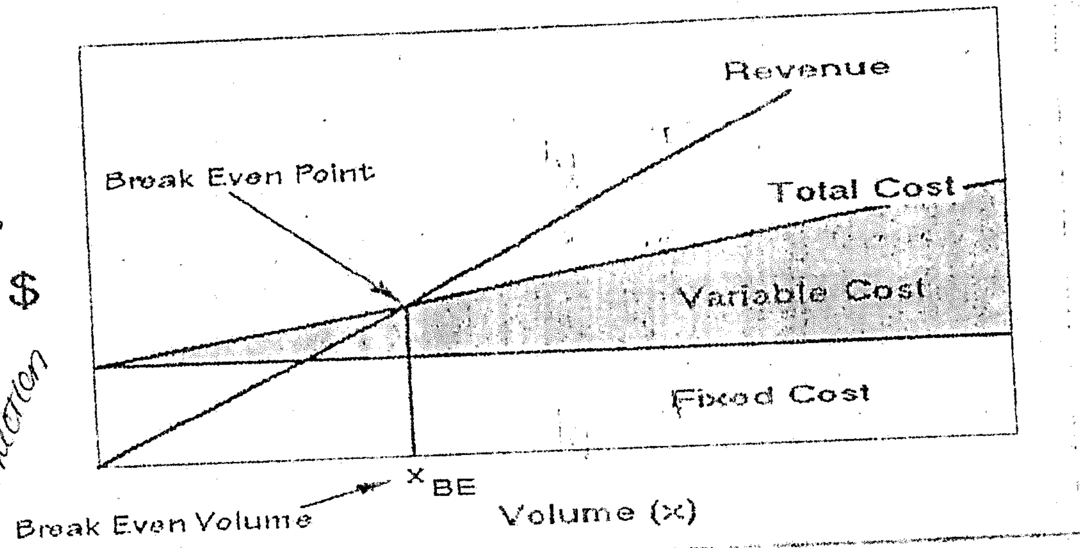
Factors that lead a firm to operate under diseconomies of scale

- Communication difficulties caused by longer chain of command
- Delays in responding to changes in the market
- Long bureaucracy system which incurs extensive

Define the following terms

- **Average variable costs-** These re total variable costs per unit of output incurred in the business.
  AVC = TVC/output
  Average fixed costs – These are total costs per unit of output. = TFC /output
  Average total costs = TC/output
- **Principle of diminishing marginal returns-** It states that average variable costs decrease with increasing scale of production until such a point where further increase in the production causes in average variable costs.
- **Marginal cost** – it is the increase in total cost resulting from raising the rate of output by one unit and calculated a D (change) in total cost divided by D (change) in total quantity (Q) produced. Hence it is called incremental cost

- **Marginal cost** is the measure of cost of producing one product hence it is called cost price per unit.
- **Break-even point** is the point where sales revenue line meets the total cost line and the firm has managed to cover up fixed costs and variable cost.
- In other words, **Break –even point** is where Total Revenue = Total Cost where the firm makes neither profit nor loss.
- **Break- even quantity- It** is the quantity where the firm covers fixed costs and variable costs. The quantity where the TR= TC



This is when increase of production of the scales of the fi

Example

Data for a hamburger stand.

$500 for booth rental per day (fixed costs)
$1 hamburger cost and labor to make the hamburger (variable costs)
$2 sales price for hamburger (price)

Qty Sold	Fixed Cost	Variable Cost	Total Cost	Revenue (price X qty)	Profit/Loss
0	$500	$0	$500	0	($500)
100	$500	$100	$600	$200	($400)
200	$500	$200	$700	$400	($300)
300	$500	$300	$800	$600	($200)
400	$500	$400	$900	$800	($100)
500	$500	$500	$1000	$1000	$0
600	$500	$600	$1100	$1200	$100
700	$500	$700	$1200	$1400	$200

Break-even production is 500 hamburgers per day.

Angle of incidence– It is the angle that reveals the rate at which the profits increases. A larger angle indicates high rate of earnings while a smaller angle indicates a low rate of earnings.

a. Margin of safety is the extent by which sales could fall before a loss is incurred.

Margin of safety = Budgeted Total revenue- Break even point sales

NB Producing any quantity less than the break even quantity the firm makes losses. Producing quantity above break-even point, the firm makes profits. The sales revenue line is also **called contributory line.**

b. **Contribution**- Contribution is the difference between total revenue and total variable costs.

In other words, **contribution** is the figure when the total variable costs/marginal costs of a number of products are deducted from the total sales revenue.

Break-even point can be defined as a point where total costs [expenses] and total sales [revenues] are equal. Break-even point can be described as a point where there is no net profit or loss. Graphically, it is a point where the total cost and total revenue curves meet.

Total Costs

Total Cost = Fixed Costs + Variable Costs:

TC = FC + VC;

Profit Relationships;

Profit = Revenue – Total Cost

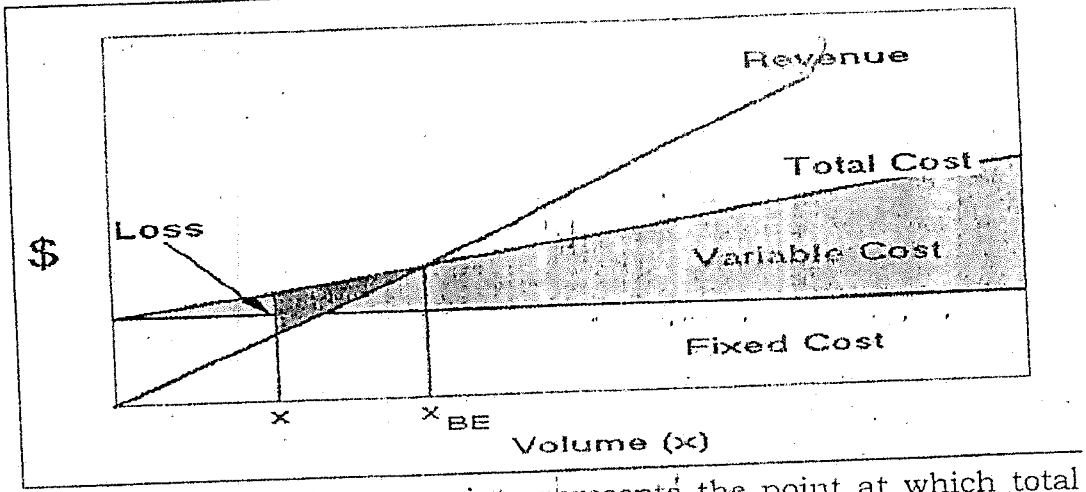
P = R – TC

P = R –{FC + VC}..

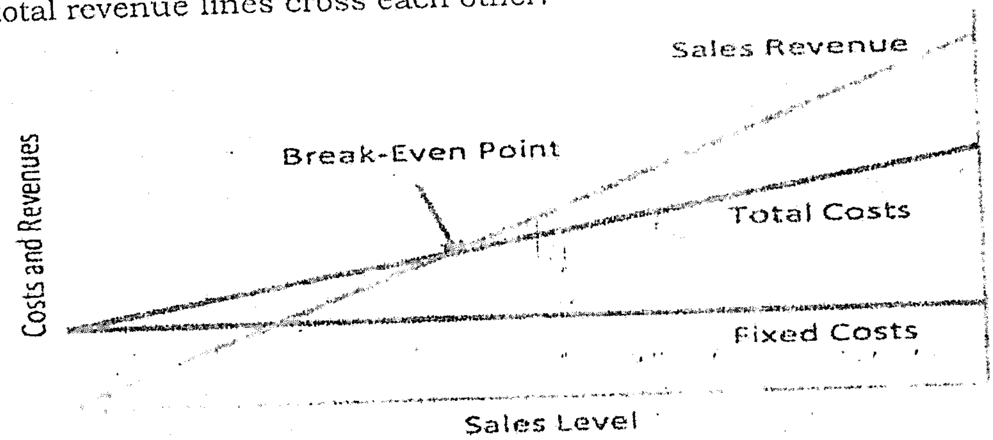
PREPARATION OF BREAK-EVEN CHART

If volume is below the BE point, the difference between the lines **represents a loss**

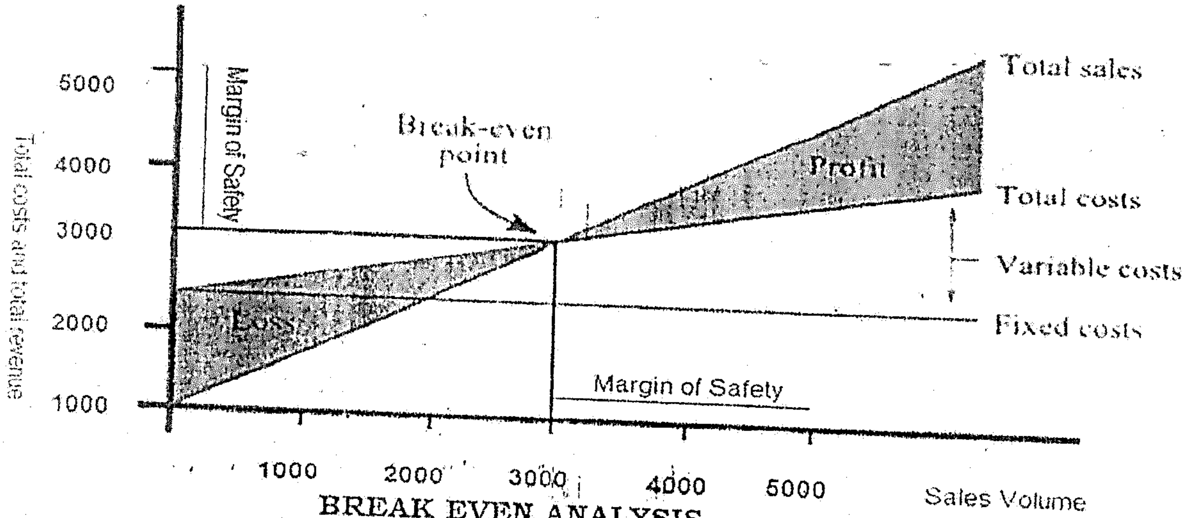
- Use the horizontal axis for units of out and vertical axis for monetary values like sales, revenue and total costs.
- As fixed costs remain the same at all output levels so the fixed costs line is drawn across the chart as a straight line parallel to the horizontal axis.
- The variable cost line commences on the vertical axis from the same point where the fixed cost line intersects the vertical axis. This is to show total cost on the chart.



- On the chart break-even point represents the point at which total cost and total revenue lines cross each other.



- The break-even point so determined tells the reader that the break-even point in terms of units of output on the horizontal axis and in terms of sales revenue and total costs on the vertical axis.
- Shaded area below the break-even point indicates losses where shaded area above the break-even point indicates profit.
- Profit and loss on break-even chart may be determined by looking at the vertical distance between the sales revenue and total cost line.
- The difference between the prevailing sales and the break-even sales represents margin of safety both in terms of sales revenue and the output level.
- If the break-even point appears well over the right side of the chart then it would imply too high total fixed costs or low contribution. This will result in lower margin of safety.
- If the break-even point or to the left side of the chart coupled with a large angle of incidence then it would imply either lower total fixed costs or high contribution.



BREAK EVEN ANALYSIS

- Break -even analysis allows you to understand what point your sales of a product or service will cover your costs. This point
- Break-even point is the point at which total cost and total revenue are equal, that is even. There is no loss or gain at this point. All costs that must be paid are paid, and there is neither profit nor loss. See the diagram below.

Table 1 : Total Revenue and Total Cost and BEP

Output in units	Total Revenue	Total Fixed Cost	Total Variable Cost	Total Cost
0	0	150	0	150
50	200	150	150	300
100	400	150	300	450
150	600	150	450	600 BEP
200	800	150	600	750
250	1000	150	750	900
300	1200	150	900	1050

(Selling Price : Rs. 4 per unit)

Factors affect the location of the business activity

- **Land cost-** High added business activities may be located in cities and towns because the benefits realized will be sufficient enough to cover for the high land costs in these sites
- **Labour costs-**the business should located in areas where is available of a pool of labour force but areas where labour costs are bearable in order to make profits.
- **Transport network- Business** enterprises should be located to busy road networks to offer convenience to consumers from all walks of life.
- **Proximity to the market/consumers** – the businesses must be located to areas which are close to their potential customers to facilitate quick distribution of products and utilization of their products by customers.

- √**Government influences on location** – The government must set up safety regulations which are conducive for business growth.
- **Social conditions**- the high literacy levels and adequate disposable income of the people in the area will promote businesses.
- √**Availability of raw materials** – the business should located to areas which are close to their raw materials

TOPIC 7 - MARKETING

Marketing is the management process of identifying, anticipating and satisfying customers' requirements efficiently and profitably.

Marketing Environment

- It refers everything, actors or forces (micro, macro and internal forces) which surrounds and impinges on the marketing management ability to develop and maintain successful transaction with its customers.

Marketing process

Marketing is a process and it comprises analysis, planning, implementation and control.

a. **Analysis** – This marketing process stage examines the position of the business in terms of its competitors, its strength, weaknesses and opportunities.
b. **Planning**– This part examines the missions/goals of the business and setting up of strategies to meet these objectives/goals.
c. **Implementation** – This part involves exploring ways of putting into effect the strategies outlined to achieve the intended purpose.
d. **Control**–This is an evaluation stage where the business must compare the onset goals to the results and carry out corrective measures where necessary.

Objectives of marketing

a. To increase market share by securing as many potential customers through reducing the prices and conducting aggressive advertising.
b. To maintain status quo. This can be done by maintaining its optimum level of scale of production without losing or seeking more.
c. To survive by withstanding the worst business conditions such as economic recession, inflation, economic depression and stagnation.
d. To maximize current profits
e. To outperform business rivals by striving to become market leaders.

Market Segment, Market Strategy and Market Research

- **Marketing strategy** – These are befitting policies adopted by a business aiming at supplying products that would satisfy customers. For example recruiting the staff who would fulfill the needs of customers rather simply minimizing a wage bill.
- **Marketing research** – Marketing research involves formal methods of collecting, analysis and disseminating information about the markets. This helps the business develop the better products which give them a competitive advantage.

- **Marketing segment** – This refers to market niches that comprise a group of average buyer who share similar needs and have similar buying potential and process. It helps the business to develop the programme to meet the needs of the average buyer

Marketing Mix

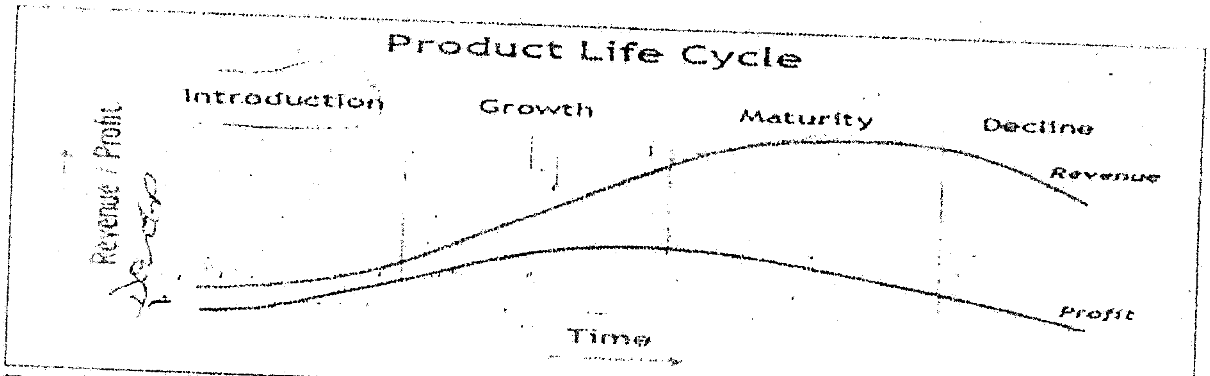
- It refers to the major elements of marketing which include the product, price, place and promotion used by the business to market its products.
- It is defined as sum of the product, price, place and promotion.

The role of product in marketing mix

The role of product in marketing is to satisfy customers' needs and wants.

What is a product life cycle?

It refers to the life span of a product from introduction through to decline. There are four stages of product life cycle.



Development stage

This is the stage where the product is being designed and developed before introducing it to the market.

1. **Introduction stage** – This is the stage the new product is introduced on the market for the first time. There are few potential customers and sales volume may be quite low.
2. **Growth stage** – This is the stage where the new product becomes a success and more customers want to buy it. At this stage the business start reaping the benefits of economies of scale.
3. **Maturity stage** – This is the stage where the number of customers of the product has stopped to increase. Sales may remain constant over a period of time and later start slow down due to the new rivals that are attracted to the market and challenges the product performance.
4. **Decline stage** – This is the stage that registers the fall of the sales revenue and since the product has been challenged and has started losing market. Eventually sales fall and the product perform poorly

The role of pricing in marketing mix

- Indicates the quality of products as high price sets precedence of high quality product while very low price levels communicate that the product is of low value

- Indicates social or ethical consideration by the business to its valued customers. A reduction in prices shows that the business considers its customers in time of economic problems.

Pricing strategies used in marketing products

1. **Cost plus pricing** – This pricing strategy is based on the total cost of production incurred in producing the products and a certain percentage is added to the marginal cost which represents the rate of the profit.
2. **Competitive based pricing** – This pricing strategy is set after examining the prices of charged by competitors and is set in line with those charged by its competitors.
3. **Demand based pricing** – This is pricing strategy that is set basing on the current demand for the product by customers. This price increases when the marketing demand rises and vice versa
4. **Penetration base pricing**- This strategy is used to introduce new products onto the markets. The product price is set at low levels in order to attract more customers and hence win more market share.
5. **Skimming based pricing** – This is a strategy whereby the new product is introduced on to the market at higher price levels in order to recover business research and development costs.
6. **Promotional based pricing** – This is the pricing strategy adopted by the business when it would like to sell off old existing products or is used to price products during festive seasons.
7. **Marketing based pricing** – This is a pricing strategy that is set basing on the social-economic class of the customers comprising the market.Prices are deliberately raised where the market comprise high class people and dropped where the market comprise low class people.
8. **Psychological based pricing** – Under this technique, the product is set at odd amount slightly below the next whole number such as K199.9 in order to drive the customers by their psychology to buy the product from the shop marked K199.9 even though they will pay K200.00 with no change.

SUPPLY AND DEMAND-PRICE MECHANISMS

- In a market economy, buyers and sellers set the prices of goods and services.
- The demand for a product is the quantity consumers are willing to buy at each of its possible prices.

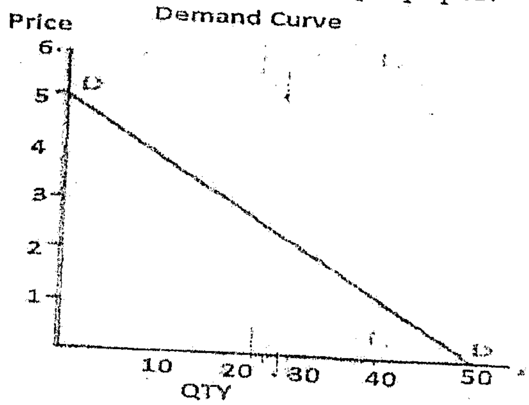
DEMAND CURVE

- The demand curve always slopes downward and to the right because more of a good will be bought at lower prices than at higher prices.
- The table below shows quantity of fish demanded at Mpondabwino Market and prices at each quaintly

Demand Schedule

Price (Rs)	Quantity Demanded (Units)
5	10
4	20
3	30
2	40
1	50

Prepare the demand schedule on the graph paper.



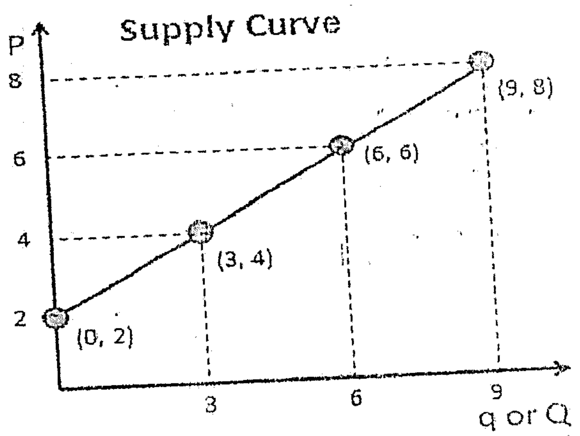
SUPPLY CURVE

- The supply curve slopes upwards to the right indicating that suppliers are willing to supply more of a product when the price is high and less when the price is low.
- The table below shows quantity of fish supplied at Mpondabwino Market and prices at each quaintly.

Price (K)	Quantity Supplied
2	0
4	3
6	6
8	9

Supply Schedule

Draw the supply curve on the graph.



DEMAND CURVE

- A demand schedule and a supply schedule are lists of quantities of a product and related prices at different levels where consumers and suppliers are willing and able to buy and supply respectively.

THE LAW OF DEMAMND AND SUPPLY

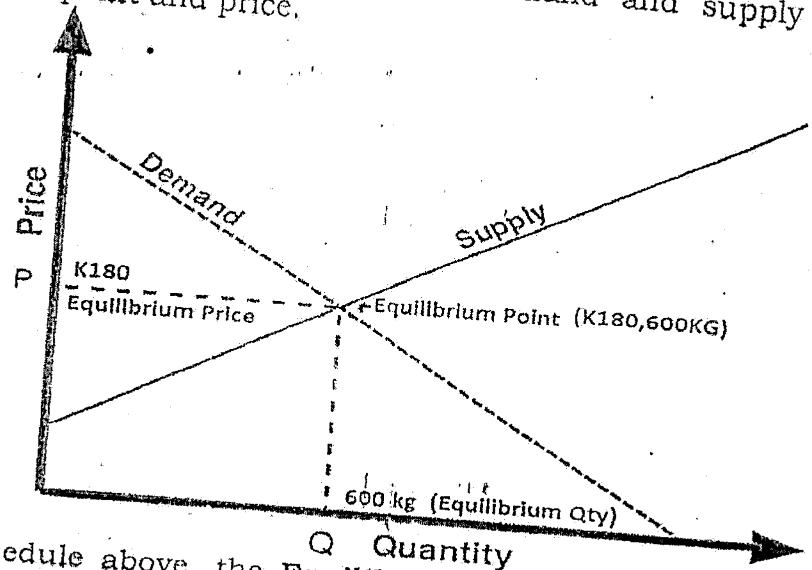
- The law of demand and supply states that people will buy more of a product when prices are low and will buy less when the price goes up. Conversely, suppliers will supply more when the price of a product is high and supply is less when the price is low.
- There is a negative relationship between price and quantity in demand where one variable increases as the other decreases.
- There is a positive relationship between price and quantity in that both price and quantity increase or decrease together.
- Price is the determining factor is quantity that responds to changes in price as the other decreases.

EQUILIBRIUM PRICE/MARKET PRICE

- It is the price where the number of sellers is willing to supply and the number of customers who are willing to buy is the same.
- The table below shows the quantity of fish demanded and supplied at Mpondabwino Market.

PRICE PER KG(MK)	QUANTITY DEMANDED	QUANTITY SUPPLIED
320	200	1000
--280	300	900
240	400	800
200	500	700
180	600	600
140	700	500
100	800	400
-60	900	300
40	1000	200
20	1100	100

Use the above table constructs the demand and supply curve to show equilibrium point and price.



From the schedule above, the **Equilibrium price** is **K180**. At this point, the quantity supplied and the quantity demanded is **600kg**. This is called the **Equilibrium Quantity.**

The role of promotion in marketing mix

As set of communication is aimed at inducing people to buy what the organisation is selling.

The main components of promotion

1. **Advertising** – It is any paid form of giving out information concerning ideas, goods or services delivered through selected media channels such as radios, television, poster, newspaper etc. It aims at increasing sales and raising the volume of profits.
2. **Public relations** – It is the art used by the business to maintain mutual understanding between the organisation and the public and the information is communicated for free.
3. **Direct marketing /personal selling** –It involves communicating to customers directly face by face and is performed by front line employees right away from gate workers, receptionist and company's resident sales persons.
4. **Sales promotion**–It is a set of trading activities such as price reduction, coupons, samples etc., in a marketing framework aimed at achieving specific sales volume or intended marketing objectives.
5. **Placing/distribution** – It is the process that involves the physical movement of goods in right quantities from one place to another place.

The role of place in marketing mix

The main role of placing is to move products from places where they are plentiful to places where they are scares.

The channel of distribution

It refers to the route through which products pass from the manufacture to the hands of the final consumer/user.

Five people involved in the channel distribution include
a. The producer
b. The retailer
c. The wholesaler
d. The consumer
e. The agents

Four types of channels of distribution

1. **Zero level channel/direct channel** – This channel comprises no channel intermediary. Goods move directly from producers to final consumers
   Advantage- It is favoured by young and growing industries because the product prices are kept low due to short distances
   Disadvantage - It does not help sellers to make more money since prices are very low.
   Products transported through this channel are perishable products such as milk, meat, tomatoes.
2. **One level channel** – This channel comprises only one channel intermediary (retailer) who relates the products from producers to final consumers.
3. **Two level channel**– This channel comprises two intermediaries, the wholesaler and the retailer.
4. **The three level channel**– It comprises three intermediaries who are the agents, wholesalers and the retailers.

Factors that affect the choice of the mode of channel of distribution

- The nature of products whether they are perishable products, nonperishable or expensive products
- The nature of the industries whether young, growing or service providing industries.
- The total financial involvement incurred in distributing the products.

CONSUMER PROTECTION

Explain the term consumer protection.

It means different ways, laws, by-laws, legislations and rules which the government and other civil society bodies follow in order to safeguard consumers' rights and freedoms.

Explain the responsibilities of the customer.

Ask questions where necessary
Inspect the property before buying it
Read I between the lines of the contract agreement before signing.

State five rights of the customer.

Right to sustainable health
Right to consumer education
Right to be satisfied
Right to be protected
Right to be informed
Right to choose
Right to be heard

Right to withdraw
Right to return the goods if they are not the ones he/she wanted.

Mention five importance of consumer protection.

It helps to promote fair trading such as that both suppliers and buyers do not complain.
It helps to safeguard consumers against exorbitant prices hence preventing exploiting them
Consumers get safe products that can not cause injury to their bodies.
Consumers are able to obtain up to date products that would not be poisonous.
It helps to reduce the proliferation of fake products on the markets.

Explain four roles played by government in protecting consumers.

1. Through presidential degree. The president may degree that shops charging high prices be closed or reduce their prices.
2. Through ministry of trade that ensures that there is even distribution of some essential commodities throughout Malawi. There are officers appointed by the government who monitor the eligibility of trade instruments including weighing scale.
3. Through establishment of regulatory bodies. The government has established regulatory bodies to safeguard the interest of the consumers. For example, MACRA that regulates ' telecommunications, National Electricity Council regulate ESCOM and the Censorship Board that protects consumer's cultural right.
4. Through establishing public bodies. Parastatals are established to provide essential goods and services at affordable prices comprehensively and continuously without selecting regions.

Describe government assizers and explain their role in protecting consumers.

These are officers who monitor the eligibility of trade instruments including weighing scale.

Identify the roles of the following consumer protection organization and association in Malawi.

a. **CONSUMER ASSOCIATION OF MALAWI (CAMA)**

Promoting environmental cleanup campaign to ensure hygiene in business place
Promote the availability of trade information to consumers through making trade publications such as magazines.
It monitors the shops to ensure that products offered for sale are of high quality and up to date.
It provides the forum to tackle issues relating to consumers interest.
It represents consumers' interests in various international trade conferences.

b. **MALAWI BUREAU OF STANDARDS(MBS)**

Setting up required standards for Malawian products.
Providing the certification of quality of products
Conducting testing process to the products before they are introduced on the

markets.
Calibrating marks on the trading equipments such as on meters, scales.

Discuss the major acts of parliament that protect consumers.

a. Competition and Fair Trading Act of 1978.

This act protects consumers against activities such those that practiced by some suppliers who put notices such as 'Goods once bought are not returnable' which violate customers right to return wrong type of goods, obtain a replacement or get a refund of cash for goods that are not fit for their intended purpose.

b. Consumer Protection Act of 1987

It ensures that children toys are safe and harmless
It ensures that the products do not kill/injure the consumer.
It ensures that the fire extinguishing equipments, hotplates and cookers are well insulated.

c. Sale of Goods Act of 1979

It ensures that that transfer of ownership of property from seller to buyer should be supported by authenticated documents.
It ensures that the supplier must be the bonafide owner of the property on sale to protect buyers from purchasing stolen items.

d. Weights and Measures Act of 1963

It lays down standard measures by which goods are sold
It empowers Government Assizers to inspect measuring devices.
It ensures that the packed goods should have the weight of the contents indicated on the pack.

e. Food and Drug Act

It controls the conditions under which the food products are produced.
It ensures that no employee smokes in the production departments and public places
It regulates the sale of drugs that may be harmful to people's live.
It ensures that manufactures of drugs should indicate

f. Description of Goods Act of 1968

It checks some suppliers who have the tendency of offering goods under a false description and makes false claims for their products.

TOPIC 8 : HUMAN RESOURCES

Human resource

It refers to the workforce supplied by the organization staff employed to exchange the organization business activities at achieving the company's goal.

PERSONNEL MANAGEMENT & HUMAN RESOURCE MANAGEMENT

A personnel management is a workforce centred directed mainly at organizations' employees and is involved in recruiting, training, payment and satisfying the while HRM is centred at the management of human resources and pays more emphasis on planning, monitoring and control.

ROLES OF THE HUMAN RESOURCE SPECIALISTS

1. They are involved in formulating plans to facilitate the acquisition, utilization and retention of other lines of human resources to achieve the corporate strategy.
2. They participate in negotiating with labour unions in policies such as conditions of employment, handling workers grievances etc.
3. They advise managers through providing accurate advices, guidance and on the implementation of the company policies.
4. They are involved in recruiting activities, arranging training and development, counselling employees etc.

They are actively involved in the actual production.

THE APPROACHES TO OR FUNCTIONS OF HUMAN RESOURCE MANAGEMENT

The following are the approaches to human resource management

1. **Recruitment-** This involves efforts to get the right people in the right job at the right time from the labour market
2. **Selection-** It is the process of acquisition of suitable candidate for the particular job after being successful in the interviews. Two techniques for selection approach are **practical tests** and **psychological tests**. **Practical tests** aim at examining the candidate's special skill while **psychological tests** are carried out to assess the candidate's personality type and attitudes.
3. **Induction-** After selection, the candidate undergoes induction process in order to become a reliable and productive member of staff. The candidate is familiarized with job descriptions, pension schemes, safety policies, statement of particulars of employment, good mannerism of the company etc.
4. **Training –** This is when the employee is equipped with the skills so that they can perform their work tasks effectively. Training also leads development of the staff so that they realize, use their potential capabilities.
   Two methods of training are
   a. **On the job training-** This involves training employees within a realistic work environment and are able to learn from established company experts.
   b. **Off the job training-**This involves employees to access external education in workshops, universities that may lead to some form of qualification or certified recognition of achievement.
5. **Dismissal-** This when the employee is fired from the job due to gross misconducts or for other disciplinary reasons.

THE STAGES OF RECRUITMENT PROCESS

1. **Existence of the vacant post –** This may due to resignation of existing employee, death of existing employee, creation of new posts etc.
2. **Advertisement-**Advertising the vacant position in the media such as radio, television, newspaper etc. if there is no existing staff to fill the post internally.
3. **Selection of interviewees-** This involves shortlisting the applicants for the interview process.
4. **Communication-**This is a process where the shortlisted applicants are informed to attend the interview. This is done through phone calls, radios, television, newspaper etc.

5. **Interview-**This involves a two way conversation aiming at collecting information from the candidate as to his/her suitability for the job.

THE QUALITIES OF THE GOOD INTERVIEWER

- Should maintain good eye contact
- Should be able to paraphrase
- Should be able to be sensitive to feedback.
- Should not be irritative
- Should be emphatic

SOURCES OF RECRUITMENT

1. **Internal source/job watch-** circulars are published internally to the existing company staff to apply.
2. **Advertising-**The job is advertised in local weekly newspapers, trade journals, radios and television.
3. **Job centres –** These include labour offices and they introduce prospective applicants to employees.
4. **Universities –** companies my directly contact the educational institutions to recruit the most recently qualified graduates.
5. **Casual enquiries-** These occur where applicants write or make phone call or visit the company personally.

THE MANAGEMENT STYLES AVAILABLE IN ORGANIZATIONS

The management styles include

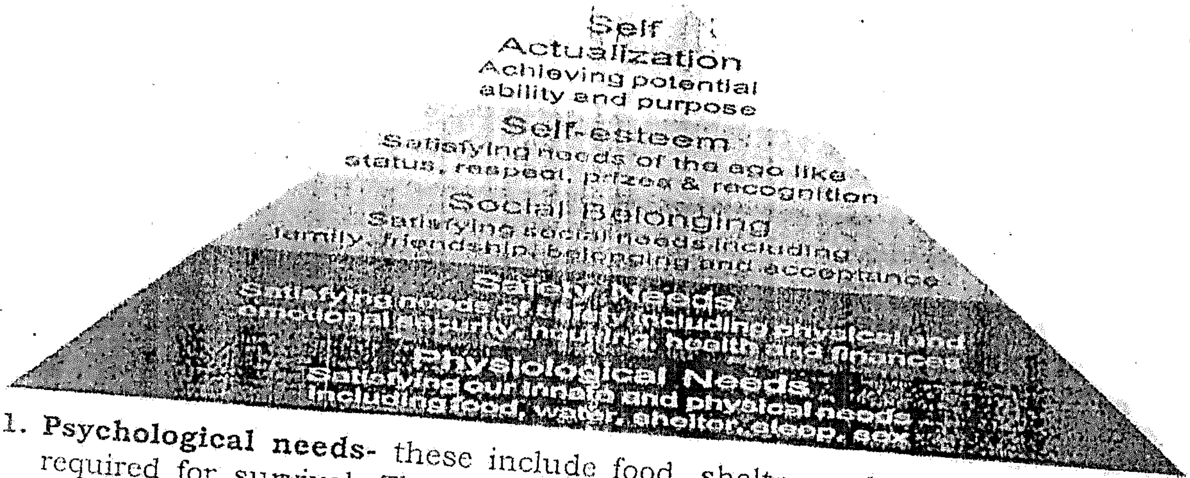
1. **Line management/scalar chain –** This involves the direct flow of command or authority from the top of an organization to the bottom. Information concerning sales, output, stocks, orders and finance extends downwards and upwards in a hierarchy through various levels of authority
2. **Tall management-** This has many levels of management. It demotivates employees because of long ladder of promotion, mainly those at the bottom. They are bureaucratic in nature.
3. **Flat management-** This has relatively few organizational levels. It brings about motivation among employees at the bottom because there is a short ladder of promotion resulting to more flexible and less risk of divergence between the objectives of one level and another.

EXPLAIN THEORY OF MOTIVATION.

Motivation refers to the whole process or factors that cause people to behave and act positively towards achieving the corporate objectives by exploiting their full potential/capabilities.

The theory of motivation has two elements content theory and process theory.

Content theory looks at factors that can cause motivation. This content theory was developed by Abraham Maslow. He developed a hierarchy of needs where the needs of individuals are categorized



1. **Psychological needs-** these include food, shelter and clothes and they are required for survival. The organization may offer good pay and cafeteria to promote physiological needs.
2. **Safety needs -** The individuals need to be protected in their homes, at work or even on the roads. The organization should ensure safe working conditions, job security, incentives to promote safety needs.
3. **Social needs –** Employees want sense of belonging, love and affection at work. There must be good leadership, co-operative work groups and acceptance.
4. **Esteem wants-** Employees require self-respect, recognition, high social status and to be praised. An organization may offer prestigious job titles, company car or mansion.
5. **Self- actualization-** The employees need them for personal creativity and advancement. The organization need may require employees matter.

FACTORS THAT RESULT TO HIGH PERFORMANCE LATE

- Personality
- Personal wants and values
- Remuneration rates
- Good working environment

FINANCIAL REWARDS

Rewards refer to the forms of payment that employees receive from an organization for supplying labour

CATEGORIES OF REWARDS OFFERED BY COMPANIES TO THEIR EMPLOYEES

1. **Financial/monetary rewards**
   Financial rewards include sickness pay, incentives, commissions, bonuses, salaries, wages etc.
2. **Non financial/non-monetary rewards**
   Non financial rewards include leave entitlement, flexible working hours, social club facilities, career breaks, educational leave/study etc.

FORMS OF FINANCIAL REWARDS

3. **Loans-** Loans are amount of money that organizations lent to employees and may be short term or long term and enable employees to purchase real estate's such as household property, cars, land and buildings etc.
4. **Incentives-** These are financial rewards offered to employee to encourage better performance and are associated with the achievement of previously set and agreed targets.
5. **Commissions-** commissions are a form of financial rewards companies pay to agents. Agents who are given possession of goods are factors, mercantile agents, auctioneers and del credele agents
6. **Bonuses-**These are financial rewards offered to employees for achieving something very outstanding and is determined by the employee's boss, the CEO or the board.
7. **Salary-** salaries are a form of financial rewards offered to employees expressed as an annual rate but payable monthly
8. **Wages-** These are financial rewards expressed on weekly or hourly and are paid out to workers on weekly basis or hourly rate.

THE DIFFERENCES BETWEEN SALARIES AND WAGES

Wages	Salaries
Normally expressed as an hourly rate	Expressed s an annual rate
Normally paid a week in arrears	Paid a month in arrears
Calculated based on piece rate and time rate	Calculated in terms of annual figure divided by 12 months
Paid either in cash or credit transfer	Typically paid automatically into bank account

FACTORS THAT DETERMINE/INFLUENCES WAGES AND SALARIES

1. **Job demand-** Risky jobs are usually paid good salaries or wages because such jobs can cost workers lives.
2. **Employee's education-** graduates get more pay than a form four or a diplomat.
3. **Employee's experience-** highly experienced employees get more pay than the less experienced due to the accrued increments over his performance for a long period of time of service on the same job.
4. **Nature of the organization-** profit oriented organizations pays more salaries than those which operate at a loss and below economies of scale.
5. **Performance at work-** those who perform well at workplace get more salaries and wages than those who do not perform well because they are rewarded extra pay in the form of bonuses, increment etc.
6. **Financial resources within the organization-** If the resources are costly, then the organization pay low salaries and wages.
7. **Organizational policies-** some organizations develop policies such as pay leader and such organizations set up highest scales and wage rates for their employees than other companies.

PAY SLIP AND PAYROLL SYSTEM

psychological needs
safety needs
Social needs
Esteem wants
Self actualization

- It is a piece of pay that stipulates salary details for a given period probably a month given to employees before pay day.
- It is a process of producing pay slips.

WHAT DOES A SALARY COMPRISE OF?

It comprise of

- **Basic pay-** this is the amount that is based on some form of fixed pay structure within which each job is allocated to a certain pay level
- **Gross pay-** this is the amount that includes basic pay plus allowances.
- **Net pay-** this is the left over or take home pay an employee actually receives and is calculated by subtracting total deductions from the gross pay.

EXAMPLE

Suppose Mr. Philip receives K720, 000 as his annual salary. Calculate his net pay after deductions of tax using the following MRA Tax schedule.

MRA TAX SCHEDULE

1st k20,000	Free or Zero
Next k3,000	15%
Excess over	30%

WORKINGS

Annual salary K720,00

Monthly pay = $\frac{k720{,}000}{12\ months}$

= K60,000

AMOUNT	TAX		REMAINDER
1ST K20,000	-	O	(60,000-20,000)= K40,000
NEXT K3,000	3000 X 15%	K450	(40,000-3,000) = K37,000
EXCESS K37,000	37,000 X30%	K11,100	(37,000-37,000) = 0
	TOTAL TAX	K11,550	

Tax calculated = K11,550

Net Pay = Gross pay – Total deductions (Tax)

=K60,000 – K11,550

= K48,450

EXAMPLE TWO

Suppose Mr. Philip receives K720, 000 as his annual salary. Calculate his net pay after deductions of tax using the following MRA Tax schedule.

MRA TAX SCHEDULE

1st k20,000	Free or Zero
Next k3,000	15%
Excess over	30%

In addition to annual pay of K720, 000, Mr. Philip receives nontaxable allowances as follows: overtime for May, 2015, K10, 000, monthly house allowances K25,000, he is deducted a loan K90,000 on a monthly installments of K24,000, pension scheme K5,000 and NICO Insurance premium of K8,000.

Required

a. Calculate the gross pay and net pay for Mr. Philip for month of May, 2015.

b. Prepare Mr. Philip's pay slip for the month of May, 2015.

WORKINGS

Annual salary K720,00

Monthly pay = $\frac{k720{,}000}{12\ months}$

= K60,000

Gross pay = K60,000 + non taxable allowances

= K60,000 + K10,000 +K25,000

= K95,000

Calculation of P.A.Y.E

AMOUNT	TAX		REMAINDER
1ST K20,000	-	O	(60,000-20,000)= K40,000
NEXT K3,000	3000 X 15%	K450	(40,000-3,000) = K37,000
EXCESS K37,000	37,000 X30%	K11,100	(37,000-37,000) = 0
	TOTAL TAX	K11,550	

Tax calculated = K11,550

Net Pay = Gross pay – Total deductions

=K95,000 – (K11,550 + K5,000 + K8,000 + K24,000)

= K95,000 – K48,550

= K48,450

PREPARATION OF PAY SLIP

Name of Co	Mr. Philip	ID T/044	District-Mzimba	Date 28/02/2015
			DEDUCTIONS	BALANCE
CODE	DESCRIPTION	PAY		
01	Basic pay	K60,000		
02	Overtime	K10,000		
03	House allowance	K25,000		
04	Loan repayment		K24,000	
05	Pension		K5,000	
06	Insurance Premium		K8,000	
07	Tax (PAYE)		K11,550	
		Gross pay K95,000	DEDUCTION K48,550	NET PAY K46,450

EXAMPLE THREE

Suppose that Mr. Thom of General Dealers Ltd gets K240, 000 as annual salary. In August, 2014, he had K500 accrued loan, K250 social club charges. Assuming that MRA has the following tax schedule.

MRA TAX SCHEDULE

	Tax free
1st k20,000	10%
Next K1,500	15%
Next k1,500	30%
Excess over	

a. Determine Mr. Thom's net pay for the month of August if General Dealers Ltd regards K4, 000 for his house allowance as taxable.

b. Prepare Mr. Thom's pay slip for the month of August, 2014.

SOLUTION

Annual salary K240,000

Monthly pay = $\frac{K240{,}000}{12\ months}$

= K20,000

Gross pay = K20,000 + non taxable allowances

= K20,000 + K4,000

= K24,000

Calculation of P.A.Y.E

AMOUNT	TAX		REMAINDER
1ST K3,000	-	O	(24,000-3,000)= K21,000
NEXT K1,500	1,500 X 10%	K150	(21,000-1,500) = K19,500
NEXT K1,500	1,500 x 20%	K3,00	(19,500-1,500) = K18,000
EXCESS K37,000	18,000 X30%	K5,400	(18,000-18,000) = 0
	TOTAL TAX	K5,850	

Tax calculated = K5,850

Net Pay = Gross pay – Total deductions

=K95,000 – (K5,850 + K500 + K250)

= K95,000 – K6,600

= K17,400

PREPARATION OF PAY SLIP

Name of Co	Mr. Thom	ID T/044	District- Mzimba	Date 28/02/2015
CODE	DESCRIPTION	PAY	DEDUCTIONS	BALANCE
01	Basic pay	K20,000		
02	House allowance	K4,000		
03	Personal Loan		K500	
04	Social club charges		K250	
05	Tax (PAYE)		K5,850	
		Gross pay K24,000	DEDUCTION K6,600	NET PAY K17,400

SYSTEMS FOR PAYING WAGES

1. **Piece rate** – this involves determining rewards by the number of units produced or the amount of work done.

Advantages

- It encourages efforts and seriousness at work
- It is a form contract to a worker hence gets more pay
- The owner of the work gets required standards of work otherwise no pay is made to the worker

Disadvantages

- Workers develop fatigue which affect performance the following day
- Workers turn money making machines resulting to overwork

- It drains more company profits because jobs on contract are expensive
- The machines may be over used leading to high wear and tear.

2. **Time rate**- this involves paying employees basing on a set rate of work per unit time.

Advantages

- It is a more revenue generating system to the workers especially with overtime
- It encourages effort and seriousness to the worker
- Output of many jobs is relatively possible to measure as compared to piece rate

Disadvantages

- Workers have a tendency of working at a slow pace in order to have overtime.
- It is very expensive to the owner more especially when many workers have overtime rate.

3. **Flat rate**- under this system a group of employees doing similar jobs are given equal rewards regardless of their levels of qualifications.

People must be treated equally

TAXATION

What is taxation?

- It is a compulsory contribution to support government in providing social, economic and development programs. Taxes are charged on people, property in come and transactions.
- **Malawi Revenue Authority** is statutory corporation is mandated to collect tax revenue in Malawi

FUNCTIONS OF MARAWI REVENUE AUTHORITY

9. Assessment, collection and receipt of specified revenue.
10. Promotion of voluntary compliance to the highest degree possible
11. Improvement of the standard of service given to taxpayers with a view to improving efficiency and effectiveness and maximizing revenue.
12. Counteracting fraud and other forms of fiscal evasion
13. Advising the minister of Finance on matters of revenue policy and administration and collection of revenue

Fraud fiscal eva

PRINCIPLES OF TAXATION

These are basic concepts which guide government in designing and implementing an equitable tax system.

The following are the principles of taxation

1. **Principle of equity**- it states that the tax system should be fair to all taxpayers
2. **Principle of certainty**- it states that a taxpayer should know how much tax and how it must be paid.
3. **Principle of convenience**- It states that taxes should collected in a convenient time
4. **Principle of efficiency**- it states that taxes should not be expensive to pay, collect and assess.
5. **Principle of impartiality**- it states that all persons in the same position should pay equal tax.

Thanks Thanks Mnangoh
3kl
Thanks

6. **The principle of adjustment**- it states that a good tax system should be capable of variations that is both up and down according to changes in policy.
7. **The principle of productivity**- it states that a good tax system should encourage productivity.

TAXES ADMINISTERD BY MALAWI REVENUE AUTHORITY

1. **Withholding Tax**

It is an advance payment of income tax that is deducted from specified payments made. A person making the payments deducts the tax at the time of paying the employee.

Example

The table below shows 14th Schedule to Taxation that is used for calculation of Withholding Tax.

July 2013 to June 2014	Rate (%)
Royalties	20
Rent	15
Payment for supplies of foodstuff to traders and institutions	3
Commission	20
Payment for services	20
Fees	10
Payment for tobacco sales	3

a. Calculate the withholding tax paid by business person who supplied beef to a hospital at a cost of K2, 000,000 and the amount paid to the trader.

Workings

The WHT rate to be use is 3%

WHT amount = 3% of K2, 000,000

= K60, 000

Amount to be paid to the trader = K2, 000, 000 – K60, 000

= K1, 940,000

b. A UN organization is a tenant in Gemini Building. Rent is payable quarterly at K500, 000 per month. What is the WHT to be collected? How much is going to be paid to the land lord.

Workings

The WHT rate to be use is 15%

WHT amount = 15% of K1,500, 000

= K225, 000

Amount to be paid to the trader = K1, 500,000 – K225, 000

= K1, 275,000

Advantages of Withholding Tax

a. The tax payer is relieved of the burden of squaring the liability at once because one pays the tax little by little.
b. You pay when money is available.
c. It accords the government a steady flow of revenue.
d. It brings people who have not registered for tax into the tax net.

2. **Income Tax**
   Income tax is the tax that is collected on income
3. **Provisional Tax**
   It is an advance payment of income tax that is made in quarterly installments which enables the taxpayer to settle the tax liability in small amounts and accords the capital a steady flow of income.
4. **Value added Tax**
   It is a general tax on the consumption expenditure that is levied on the value added that has been created at various stages in the production and distribution chain
5. **Pay as You Earn**
   It is a method of collecting income tax in advance and is applicable to individuals who derive an income from employment. It is collected by the employers by deducting from payment paid to their employees and they remit them to MRA.
   Advantages to Tax Payers
   a. It is convenient to pay when money is available
   b. It is easy and cost effective.
   c. It is affordable for the tax payer to pay by installment rather than having to pay a lump sum.
   Disadvantages to Tax Authorities
   a. It provides constant flow of revenue
   b. It is easy and cost effective to collect
   c. It discourages and checks tax evasion
6. **Construction and Property Tax**
   It is the tax that is chargeable on rent and sale of commercial property. construction as a service and materials for construction.
7. **Fringe benefit Tax**
   It is the tax that is charged upon the taxable values of fringe benefits being provided by an employer to an employee.
8. **Capital Gain Tax.**
   A capital gain is a profit that results from a disposition of a capital item such as stock or property where the amount realized on the disposition exceeds the purchase price

Two main broad types of taxes

1. **Direct taxes**
   These are taxes imposed directly on income of business, employment, property and the burden of the tax is borne by the individual or business entity.
   Examples of direct taxes include
   - PAYE
   - Fringe benefit tax
   - Corporate tax

Advantages of direct taxes

- Provide constant flow of revenue to the government

- Easy and cost effective to collect
- Discourage and check tax evasion

2. Indirect taxes

These are taxes levied on consumption of goods and services collected by a tax payer. It is collected by the seller of the products on behalf of the government and paid over at a later date..

- Examples of indirect taxes include
- VAT
- Excise tax
- Import duty etc.

Advantages

- They help to raise state revenue.
- Custom Duties are also levied on imports to protect domestic industries from more efficient or competitors from abroad.
- Custom Duties can be levied on exports in order to limit the existence or outflow of home products

FORMS OF TAXES

1. Value Added Tax

- It is a general tax on the consumption expenditure that is levied on the value added that has been created at various stages in the production and distribution chain. It is also levied on goods and services imported into Malawi.
- VAT is added to the prices of products we all buy. It is charged on expenditure rather on income.
- The standard rate for VAT is now 16.5%

EXAMPLE

A manufacture sells to the wholesale at K1, 000 plus VAT of 16.5%. The wholesaler sells the goods to the retailer at K1, 200 plus VAT.

a. Calculate the VAT paid by the manufacturer, the wholesaler, the retailer and the consumer.
b. Calculate the amount paid by the wholesaler, the retailer and the consumer.

WORKINGS

Illustration of the calculation of VAT from the manufacturer to consumer

	Selling price	VAT at 16.5%	Total Amount(K)	Amount to MRA (K)
Manufacturer to the wholesaler	1,000	165	1,165	165
Wholesaler to Retailer	1,200	198	1398	33
Retailer to consumer	1,610	265.65	1,875.65	67.65

a. The wholesaler pays = K1, 165 (16.5% X K1, 000 + K1, 000)

The manufacturer pays VAT = K165 remitted to MRA

b. The retailers pays= K 1,398 (16.5% X K1,200= K198 + K1,200)
The Wholesaler pays VAT = K198-K165
=K33

c. The consumer pays = K1,875.65 (16.5%xK1,610 = K265.65 + K1,610)
The retail remits VAT = 265.65 -198

2. **Domestic Excise**
Domestic Excise is tax that is levied on the production of certain locally manufactured products such as spirits, perfume, beer etc.
Domestic Excise acts as a source of revenue and also as a control measure on the production or consumption of certain luxurious goods.

3. **Custom Duties**
- These are taxes levied on imports and sometimes on exports by the custom authorities of the country in order to raise state revenue.
- Custom Duties are also levied on imports to protect domestic industries from more efficient or competitors from abroad.
- Custom Duties can be levied on exports in order to limit the existence or outflow of home products.
- It may take the following forms

a. **Advalorem Duty** – it is when custom duty is based on the value of goods
b. **Specific Duty** – it is where it is based on the weight of the goods.
c. **Preferential Duty-** It is when it is based on where the goods come from.

4. **Dumping Duties**
These taxes are imposed imported goods to prevent dumping into the country. Goods are said to be dumped if they are brought onto the market at less than what they cost in the source country.

THE PURPOSES/ ROLE OF TAXATION

1. To raise government revenue for the construction of public goods such as schools, roads, hospitals etc.
2. It is used as expenditure control mechanism whereby the government increases tax to reduce disposable pay in order to control inflation because total spending is reduced.
3. It is used to redistribute wealth for political and social reasons
4. It is used to increase the volume of both home and foreign trade
5. It is used to discourage the consumption of demerit goods such as beer, spirit and cigars.
6. It is used to protect local industries to encourage to develop hence creating employment opportunities by imposing high taxes on imports

STAGES OF DETERMINING TAXABLE INCOME

1. **Gross income**- this is the total amount of cash or any capital gain received by a person within or deemed to be within Malawi. It includes monthly or annual salaries, bonuses, overtime, gratuities, leave grant, pension and cash allowances etc. received in the course of employment.
2. **Assessable income**- this computed by excluding from gross income any amount that are exempted from tax such as the salary and payment to the

president and vice president that they receive from the government, allowances made to members of National assembly and up to K50, 000 of any amount paid by an employer to an employee who has been declared redundant.

3. **Taxable income**

   This is the result one gets after deductions are made and may include exemptions such as subsistence allowance, professional subscription and donations of not less than K250 to charitable organizations.

METHODS OF COLLECTING TAX USED BY MRA

1. **P.A.Y.E (Pay As You Earn)**

   It is a method of collecting income tax in advance and is applicable to individuals who derive an income from employment. It is collected by the employers by deducting from payment paid to their employees and they remit them to MRA.

2. **Corporation Tax**

   This is the tax that is levied on the firm's profit after expenses and capital allowances have been deducted from the revenue during a given taxable period.

3. **Capital Gains**

c. A capital gain is a profit that results from a disposition of a capital item such as stock or property where the amount realized on the disposition exceeds the purchase price.

d. In other words, it is the tax obtained from the profit that results from a disposition of capital item such as stock, bond, real estate, property where the amount realized on the disposition exceeds the purchase price.

   Capital gain = Higher Selling Price – Lower Purchase Price

- Capital Gain Tax is the tax on the gain/profit made when the property or stock is disposed of.

EXAMPLE

Suppose a company bought a motor vehicle at K120, 000,000 in 2001. In 2010, the asset was disposed off. Assuming that the conversion factor in 2010 is 1.305825 and the tax rate for capital gain is 30%. Calculate the Capital Gains Tax.

WORKINGS

Initial cost of the motor vehicle	= K120,000,000
The rate for capital gain tax	= 30%
Conservation factor(2010)	= 1.305825
Net Book Value	= K120,000,000 x 1.305825
Disposal/selling price	= K156,699,000
Capital gain	= K156,699,000- K120,000,000 =K36,699,000
Capital Gain Tax	= 36,699,000 x 30%
	= K11,009.70

TOPIC 9 : BUSINESS ACCOUNTING

$(T^2)^2 = 11\ T^{92}$

Accounting refers to the gathering and recording of financial information and summarizing and analyzing it for the use by various stakeholders

USERS OF ACCOUNTING INFORMATION

The following are the users of accounting information and their requirements

1. Shareholders/owners

They are the owners of the business and would like to know the value of the business so as to assess their net worth and how much return they should expect from the business.

2. Employees

The employees would like to assess the performance of the business in assessing their job security. In addition, the employees use financial information when negotiating remuneration increases.

3. Suppliers/creditors

The suppliers want to be assured that the business will be able to pay off the bills.

4. Government/Trade partners

It helps the government/MRA to how much corporation tax; value added tax and PAYE, the business collects from employees on its behalf.

5. Financial institutions/financiers

Financial institutions do provide credit facilities to the business and they need financial information to be assured that the company will be able to pay back the loans on their due dates.

6. Management

Financial information act as a yard stick in assessing how the business is performing for planning purpose and decision making.

7. Customers

The information from the balance sheet will help them to be assured that the company is the secure and reliable source of supplies and hence cannot close down

ACCOUNTING EQUATION

What is accounting equation?

It is the algebraic equation which expresses the whole of the financial accounting and include the expression of capital, assets and liabilities. The accounting equation is expressed as shown below

Assets = Capital + Liabilities

Basic elements of financial statements

1. **Capital-** The amount set aside by the owner to start business. Capital represents the difference between assets and liabilities.
2. **Assets-** Assets are resources owned by the business which are expected to bring future economic benefits to the enterprise. Assets are categorized as current and non-current.
3. **Liabilities-** Liabilities is the amount which the business owes. Liabilities represents obligation to transfer economic benefits to other entities as a result of past obligations

EXAMPLE

Thanks: ronango

Suppose the company has assets totaling to K20, 000 and liabilities totaling K15, 000, calculate value of capital.

Workings

Assets = Capital + Liabilities
K20,000 = capital + K15,000
Capital = K20,000 – K15,000
= K5,000

ACCOUNTING EQUATION

- The accounting equation is: **Capital = Assets – Liabilities.**
- The two side of the accounting equation are represented by the two parts of the balance sheet.
- The totals of one part of the balance sheet should always be equal to the total of the other part.

The following information relates to business transactions of Mr Mphande Enterprise for the year ending 30th May, 2007.

Assets	
Shop	K
Cash at bank	32,000
Creditor	28,000
Capital	7,000
Stock of goods	60,000
	7,000

Workings

B Blake

Balance Sheet as at 6 May 2007

Fixed Assets		
Shop	K	K
Current assets		32,000
Stock of goods		
Cash at bank	7,000	
	28,000	
Less Current liabilities	35,000	
Creditor		
Working capital	(7,000)	
Total assets		28,000
Financed by		60,000
Capital 60,000		
		60,000

The following information relates to business transactions of Mr Mphande Enterprise for the year ending 30th May, 2007.

Assets	
Shop	K
Debtor	32,000
Cash at bank	600
Creditor	25,400
Capital	4,000
	60,000

Stock of goods	6,000

Prepare balance sheet as at 30th May, 2007.

B Blake

Balance Sheet as at 6 May 2007

	K	K
Fixed Assets		32,000
Shop		
Current assets		
Stock of goods 7,000	6,000	
Debtor	600	
Cash at bank	25,400	
	32,000	
Less Current liabilities		
Creditor	(4,000)	
Working capital		28,000
Total Assets		60,000
Financed by		
Capital		60,000

NOTE

- **Fixed assets** are assets which have a long life bought with the intention to use them in the business and not with the intention to simply resell them, e.g. **buildings, machinery, fixtures, motor vehicles.**
- **Current assets** are assets consisting of cash, goods for resale or items having a short life. For example, **the value of stock in hand** goes up and down as it is bought and sold. Similarly, the **amount of money owing to us by debtors** will change quickly, as we sell more to them on credit and they pay their debts. The **amount of money in the bank** will also change as we **receive** and pay out money.
- **Current liabilities** are those liabilities which have to be paid within no more than a year from the date on the balance sheet, e.g. **creditors for goods bought.**

EQUALITY OF THE ACCOUNTING EQUATION

A SUMMARY OF THE EFFECT UPON ASSETS, LIABILITIES AND CAPITAL OF EACH TYPE OF TRANSACTION

- Every transaction affects two items in the accounting equation. Sometimes that may involve the same item being affected twice, once positively (going up) and once negatively (going down).
- Every transaction affects two items in the balance sheet.

Example of transaction	**Effect**	
• Owner pays capital into the bank	Increase asset **(Bank)**	Increase **capital**
• Buy goods by cheque	Decrease asset **(Bank)**	Increase asset **(Stock of goods)**
• Buy goods on credit	Increase asset **(Stock of goods)**	Increase liability **(Creditors)**

• Sale of goods on credit	Decrease asset **(Stock of goods)**	Increase asset **(Debtors)**
• Sale of goods for cash (cheque)	Decrease asset **(Stock of goods)**	Increase asset **(Bank)**
• Pay creditor	Decrease asset**(Bank)**	Decrease liability**(Creditor)**
• Debtor pays money owing by cheque	Increase asset **(Bank)**	Decrease asset **(Debtors)**
• Owner takes money out of the business bank account for own use (Bank)	**Decrease asset**	Decrease **capital**
• Owner pays creditor from private money	**Decrease liability**	**Increase capital**

Exercise

1. B Wise is setting up a new business. Before actually selling anything, he bought a van for K4, 500, a market stall for K2, 000 and a stock of goods for K1, 500. He did not pay in full for his stock of goods and still owes K1, 000 in respect of them. He borrowed K5, 000 from C Fox. After the events just described, and before trading starts, he has K400 cash in hand and K1, 100 cash at bank. Calculate the amount of his capital.

2. F Flint is starting a business. Before actually starting to sell anything, he bought fixtures for K1, 200, a van for K6, 000 and a stock of goods for K2, 800. Although he has paid in full for the fixtures and the van, he still owes K1, 600 for some of the goods. B Rub lent him K2, 500. After the above, Flint has K200 in the business bank account and £175 cash in hand. You are required to calculate his capital.

3. Draw up G Putty's balance sheet from the following information as at 31 December 2008:

Capital	£
Debtors	7,200
Van	1,200
Creditors	3,800
Fixtures	1,600
Stock of goods	1,800
Cash at bank	4,200
	300

4. Draw up A Brick's balance sheet as at 30 June 2006 from the following items:

Capital	K
Equipment	10,200
	3,400

Creditors	4,100
Stock of goods	3,600
Debtors	4,500
Cash at bank	2,800

5. G Brown has the following items in her balance sheet as on 30 April 2008:

Capital	K18,400
Creditors	K2,100
Fixtures	K2,800
Car	K3,900
Stock of goods	K4,550
Debtors	K2,780
Cash at bank	K6,250
Cash in hand	K220.

During the first week of May 2008

a. She bought extra stock for goods K400 on credit.
b. One of the debtors paid her K920 by cheque.
c. She bought a computer by cheque K850.

You are asked to draw up a balance sheet as on 7 May 2008 after the above transactions have been completed.

6. J. Hill has the following assets and liabilities as on 30 November 2009: Creditors K2,800; Equipment K6,200; Car K7,300; Stock of goods K8,100; Debtors K4,050; Cash at bank K9,100; Cash in hand K195.

You are not given the capital amount at that date. During the first week of December 2009

a. Hill bought extra equipment on credit for K110.
b. Hill bought extra stock by cheque K380.
c. Hill paid creditors by cheque K1, 150.
d. Debtors paid Hill K640 by cheque and K90 by cash.
e. Hill put in an extra K1, 500 into the business, K1, 300 by cheque and K200 in cash.

You are to draw up a balance sheet as on 7 December 2009 after the above transactions have been completed.

✱ BOOKS OF PRIME ENTRY

- Books of Prime entry are the books in which we first record t transactions. These are not accounts; they are simply books that records the details of a transactions, almost like a diary.
- The firm will have a separate book for each kind of transaction. The type of the transaction will affect which book it, is entered into. Sales will be entered in one book, purchases in another book, cash in another book, and so on.
- Several books of prime entry exist, each recording a different type of transaction

BOOK OF PRIME ENTRY	TRANSACTION TYPE

Sales day book	Credit sales
Purchases day book	Credit purchases
Sales returns day book	Returns of goods sold on credit
Purchases returns day book	Returns of goods bought on credit
Cash book	All bank transactions
Petty cash book	All small cash transactions
The journal	All transactions not recorded elsewhere

COMPONENTS OF THE BOOKS OF PRIME ENTRY

The books of prime entry are used to record the following:

1. The date on which each transaction took place - the transactions should be shown in date order;
2. Details relating to the transactions are entered in a 'details' column; e.g. name of customer/supplier
3. A folio column entry is made cross-referencing back to the original 'source document', e.g. the invoice;
4. The monetary amounts are entered in columns included in the books of original entry for that purpose.

ADVANTAGES OF KEEPING BOOKS OF ORIGINAL ENTRY

1. Accounts can be found more easily by the use of the cross referencing nature of the books of original entry being kept.
2. If records are lost then the ledgers and the books of original entry acts as a backup for each other.
3. Acts as a 'listing device' for posting totals to various accounts, thereby saving labour.
4. Similar transactions are recorded in the same book and easy to account in the ledger.
5. To minimize memory lapses and omissions.
6. Any errors in posting of entries can be quickly identified and resolved.
7. The ability to carry on business transaction with good control.
8. As different staff members will enter the books of prime entry accounting activities will become easier

The commonly used books of original entry together with source document it used to record transactions are:

Book of prime entry	**Transaction type**	**Source documents**
Sales day book	Credit sales	Sales invoice
Purchases day book	Credit purchases	Purchase invoice
Sales returns day book	Returns of goods sold on credit	Credit notes
Purchases returns day book	Returns of goods bought on credit	Debit notes
Cash book	All bank transactions	Cheque counterfoils (From the cheque book to show cheques paid out), paying in slips(Evidence of money paid into bank

		accounts), till rolls (Evidence of cash being received).
Petty cash book	All small cash transactions	Petty cash vouchers
The General journal	Transactions not recorded in other books of prime entry	Journal Voucher

SALES DAY BOOK

- A book in which non-cash sales are recorded with details of customer, invoice, amount and date; these details are later posted to each customer's account in the sales ledger.
- A sales book is also known as sales day book is a book of prime entry in which are recorded the details of credit sales made by a businessman. Total of sales book shows the total credit sales of goods during the period concerned. Usually the sales book is totaled every month.
- The sales day book is written up daily from the copies of invoices sent out.
- All credit sales should be entered into the sales daybook.
- The source document for the sales daybook is the sales invoice. A sales invoice is simply a business document containing all the details of the sale made. The business will keep a copy and will send another copy of the invoice to the customer.
- Details contained on the sales invoice would include:
  1. Name of customer
  2. Address of customer
  3. Date of sale
  4. Value of sales
  5. Any trade discount
  6. Any cash discount - and details of the conditions
  7. Invoice number
- The sales book summarizes the daily sales made on credit terms (i.e. the goods are sold and payment is collected at a later date).

SALES JOURNAL

Date	Invoice	Customer	LF	K
30.4.14	1	Ruwan		4,900
30.4.14	2	Nuwan		3,800
30.4.14	3B	Kamal		2,700
30.4.14	4	Sunil		10,500
30.4.14	5	Amal		2500
Total for 30.4.14				24,400

The total sales for the day of K24, 400 will be entered into the accounting ledgers in double entry format. **Or**

SALES JOURNAL

- The book of prime entry used to record the sales of goods on credit is the sales Journal or Sales Day Book.
- The source document relevant to the sales Journal is **the Invoice (Sales invoice);.**
- Then sales are made on credit, while a percentage from the marked price may be reduced it is known as a Trade discount.
- This trade discount is only a reduction of the price in the invoice. It is not accounted for separately.
- While debtors are created when the business makes sales on credit, they are considered an asset to the business.

RETURNS INWARD JOURNAL

- Goods sold on credit may be returned by the customers for the following reasons:
  a. As the date of expiry has passed ;
  b. Goods supplied being different to what was ordered
  c. Being damaged goods
- The book of prime entry used to record the returns inwards is **the Returns Inwards Journal or Returns Inwards Book.**
- The source document used as the basis to record returns is the **Credit Note.**
- The Returns Inwards Journal of a business registered for VAT could take the following format:

Returns Inwards Journal or Returns Inwards Book

Date 2018	Debit Note No.	Supplier	Amount	VAT	Total Amount	L.F.
06 Apr	15	Sarath Traders		XX	XX	XXX
25 Apr	16	Vimal & Brothers		XX	XX	XXX
30 Apr	Transferred to General Ledger			XX	XX	XXX

- On the respective dates the invoice value and the amount of VAT must be credited to respective debtor's accounts in the Debtors sub ledger.
- At the end of the period the total in the 'amount' column must be debited to the Returns Inwards account in the General ledger and credited to the Debtors Control account. The total in the VAT column must be debited to the VAT account must be credited to the Debtors Control account.

PURCHASES BOOK OR PURCHASES DAY BOOK

- The book of prime entry used to record goods purchased on credit is the Purchases Journal or Purchases Day Book. Purchases book or purchases day book is a book of original entry maintained to record credit purchases.
- The source document relevant to the purchases Journal is the Invoice (Purchase Invoice). Purchases book is written up daily from the **Purchases**

Invoices received. The invoices are consecutively numbered. The invoice of each number is noted in the purchases book.

- The purchase day book summarizes the daily purchases made on credit terms (i.e. the goods are purchased and payment is made at a later date).
- While a certain percentage will be reduced from the marked price when goods for trading are purchased, this is known as a Trade discount.
- The amount of the trade discount is reduced from the invoice value only. There isn't a separate accounting entry.
- The suppliers who provide goods to the entity are **creditors** to the business. They are considered as liabilities of the business.
- The respective amounts and the VAT must be entered separately in the individual creditor's accounts in the Creditors sub Ledger.
- At the end of the period the columnar totals of the Purchases Journal must be debited to the Purchases A/c and credited to the Creditors Control account. The total in the VAT column must be debited to the VAT A/c and credited to the Creditors Control A/c.

Purchases Journal

Date 2017	Invoice No.	Supplier	Amount	VAT	Total Amount	L.F.
01 Mar	264	Nelum & Co.		xx	xx	xxx
25 Mar	610	Daya & Co.		xx	xx	xxx
31 Mar	Transferred to General Ledger			xx	xx	xxx

RETURNS OUTWARD JOURNAL

- Goods purchased on credit may be returned to the suppliers for the following reasons.
  a. The expiry date has passed
  b. The goods received being different to the order
  c. Goods supplied being damaged
  d. Delay in receiving goods
- The book of prime entry for recording goods returns is the Returns Outwards Journal or Returns Outwards Day Book.
- The source document used to record goods returns is the Debit Note.

The format of the Returns Outwards Journal could be as follows.

Date 2017	Debit Note No.	Supplier	Amount	VAT	Total Amount	L.F.
05 Mar	15	Manel & Co.		xx	xx	xxx
29 Mar	16	Kumara & Co.		xx	xx	xxx
31 Mar	Transferred to General Ledger			xx	xx	xxx

CASH BOOK

- Cash book is a book in which all the transactions relating to cash receipts and cash payments are recorded. It starts with the cash or bank balances at the beginning of the period.
- It serves the purpose as both the journal as well as the ledger (cash) account.

- It is also called the book of original entry. When a cash book is maintained, transactions of cash are not recorded in the journal, and no separate account for cash or bank is required in the ledger.

ADVANTAGES OF CASH BOOK

1. Traces mistakes. The balance of the cashbook can be verified by matching with the actual cash in hand.
2. Daily records. The cash transactions are recorded promptly in the cash book which helps in maintaining a regular record of the cash receipts and payments.
3. Helps to determine receipts and payments made on specific dates
4. Identifies defaults
5. Determines cash in hand. It provides a clear picture of the remaining balance or cash in hand left with the organization.
6. Saves time, cost and labour

TYPES OF CASH BOOK

1. Single column cash book
2. Double column cash book
3. Three column cash book

SINGLE COLUMN CASH BOOK

Single column cash book records only cash receipts and payments. It has only one money column on each of the debit and credit sides of the cash book. All the cash receipts are entered on the debit side and the cash payments on the credit side.

A DOUBLE COLUMN CASH BOOK

A double column cash book or two column cash book is one which consists of two separate columns on the debit side as well as credit side for recording cash and discount. These allowances are made for prompt settlement of accounts. In certain business almost all receipts or payments are accompanied by such discounts and in order to avoid unnecessary postings separate columns in the cash book are introduced to record the discounts received or allowed. The discount column on the debit side of the cash book will record discounts allowed and that on the credit side discounts received.

A THREE COLUMN CASH BOOK

A three column cash book or treble column cash book is one in which there are three columns on each side - debit and credit side. One is used to record cash transactions, the second is used to record bank transactions and third is used to record discount received and paid.

When a trader keeps a bank account it becomes necessary to record the amounts deposited into bank and withdrawals from it. For this purpose one additional column is added on each side of the cash book. One of the main advantages of a three column cash book is that it is very helpful to businessmen, since it reveals the cash and bank deposits at a glance

WRITING A THREE COLUMN CASH BOOK:

OPENING BALANCE:

Put the opening balance (if any) on cash in hand and cash at bank on the debit side in the cash book and bank columns. If the opening balance is credit balance (overdraft) then it will be put in the credit side of the cash book in the bank column.

CHEQUE/CHECK OR CASH RECEIVED:

If a cheque is received from any person and is paid into the bank on the same date it will appear on the debit side of the cash book as "To a Person". The amount will be shown in the bank column. If the cheque received is not deposited into the bank on the same date then the amount will appear in the cash column. Cash received will be recorded in the usual manner in the cash column.

PAYMENT BY CHEQUE/CHECK OR CASH:

When we make payment by cheque, this will appear on the credit side "By a person" and the amount in the bank column. If the payment is made in cash it will be recorded in usual manner in the cash column.

CONTRA ENTRIES:

If an amount is entered on the debit side of the cash book, and the exact amount is again entered on the credit side of the same account, it is called "contra entry". Similarly an amount entered on the credit side of an account also may have a contra entry on the debit side of the same account.

CONTRA ENTRIES ARE PASSED WHEN:

Cash is deposited into bank by office: It is payment from cash and receipt in bank. Therefore, enter on credit side, cash column "By Bank" and on debit side bank column "To Cash". The reason for making two entries is to comply with the principle of double entry which in such transactions is completed and therefore, no posting of these items is necessary. Such entries are marked in the cash book with the letter "C" in the folio column.

Cheque/Check is drawn for office use: It is payment by bank and receipt in cash. Therefore, enter on the debit side, cash column "To Bank" and on credit side, bank column "By Cash".

BANK CHARGES AND BANK INTEREST ALLOWED:

Bank charges appear on the credit side, bank column "Bank Charges." Bank interest allowed appears on the debit side, bank column "To Interest".

The main advantages of cash book are as follows:

1. To have systematic and permanent record of all cash and banking transactions in a separate book.
2. To obtain reliable and detailed information of all cash receipts and payments easily and immediately.
3. To keep effective control over misappropriation of cash and banking transaction.
4. To know the main sources and heads of payment of cash.
5. To know cash and bank balances.
6. To help to prepare cash budget and to avoid the possibility of having excess or shortage of cash.
7. To make the cashier and other concerned officers accountable for all cash and banking transactions.

Example

The cash book comprises cash account and bank account combined.

Items entered in the cash books are as follows

1. Debit cashbook receipts by cheque in the bank column
2. Debit cash book receipts by cash in the cash column.
3. Credit cash book by cheque payment into the bank column
4. Credit cash book by cash payment in the cash more

Example

Prepare GT Supermarket cash book from the following details.

2015		K
Sept 1	The proprietor put capital into the bank for business	**94,000**
Sept 2	Received cheque from Loveness	**11,500**
Sept 4	Cash sales	**10,200**
Sept 6	Paid rent by cheque	**3,500**
Sept 7	Bank cash from the business	**5,000**
Sept 15	Cash sales paid direct into the bank	**4,000**
Sept 23	Paid cheque to John	**27,700**
Sept 28	Withdraw cash from the bank for office	**12,000**
Sept 29	Withdraw cash from the bank for personal use	**2,000**
Sept 30	**Paid** wages in cash	**11,800**

Workings

GT Supermarket cash book

DR				CR			
Date	Details	cash	bank	Date	details	cash	bank
2015				2015			
Sep 1	Capital		94,000	Sept 6	Rent		3,500
Sept 2	Loveness		11,500	Sept 7	Bank		5,000
Sept 4	Sales	10,200		Sept 23	John		27,700
Sept 7	Cash	5,000		Sept 28	Cash		12,000
Sept 15	Sales	4,000		Sept 29	Drawing		2,000
Sept 28	Bank		12,000	Sept 30	Wages	11,800	2,000
				Sept 30	Bal c/d	5,400	69,300
		22,200	114,500			22,200	114,500
1st Oct	Bal b/d	5,400	69,300				

Enter the following transactions in a three column cash book and find out the balances as on 16th January, 2002.

Date	transactions
1	Cash in hand K3,000; balance at bank K10,000
3	Sold goods for cash K10,000
4	Deposited into the bank K8,000

5	Received from Nattu K4,000 and allowed him discount K100
6	Paid house rent by cheque K1,000
7	Paid to Shan K5,000 and received discount K50
9	Withdrew from bank for office use K5,000
10	Received cheque of K470 from Mohan in full settlement of his account K500.
11	Cash sales deposited into the bank K2,500
12	Cash sales K1,000
13	Paid Alan by cheque against his claim of K2, 000 at a discount of 5%.
14	Paid travelling expenses K7,00
15	Draw a cheque for personal use K1,000

CASHBOOK

Date	Particulars	Dis	Cash	Bank	Date	Particulars	Dis	Cash	Bank
2002					2002				
1	To Bal b/d		3,000	10,000	4	By Bank		8,000	
3	To Sales		10,000		6	By Rent			1,000
4	To Cash			8,000	7	By Shan	50	5,000	
5	To Nattu	100	4,000		9	By Cash			5,000
9	To Bank			5,000	13	By Alan	100		1,900
10	To Mohan	30		470	14	By T exp		700	
11	To Sales			2,500		By Drawi			1,000
12	To Sales		1,000		16	By ba c/d		9,300	12,070
	Total	**130**	**23,000**	**20,970**			150	23,000	20,970
16	To bal b/d		9,300	12,070					

Example

A businessman had K130, 000 cash in hand on 1st September and ended up conducting the following transactions in the month of September.

Date	TRANSACTIONS	AMOUNT -K
2	Banked	120,000
3	Sold fish cash	60,000
3	Paid wages cash	10,000
3	Paid transport by cheque	20,000
5	Sold fish cash	110,000
5	Transport paid by cheque	30,000
10	Paid wages cash	10,000
17	Sold fish cash	90,000
17	Transport by cheque	30,000
17	Paid wages by cash	10,000
17	Banked	120,000
24	Sold fish by cheque	105,000
24	Paid wages cash	10,000
24	Transport by cheque	32,000
24	Baked	60,000

30	Sold fish cash	110,000
30	Paid net repairs by cheque	80,000
30	Paid for transport	15,000

Prepare cash book from the above transactions.

Cash book

Date	RECEIPTS	Cash	Bank	Date	Payment	Cash	Bank
1	Bal b/d	130		2	Bank-c	120,00	
2	Cash		120,000	3	Wages	10,000	
3	Sales	60		3	Transport		20,000
5	Sales	110,000		5	Transport		30,000
17	Cash	90,000		10	Wages	10,000	
17	Sales		120,000	17	Wages	10,000	
24	Sales	105,000		17	Bank-c	120,000	
24	Cash		60,000	17	Transport		30,000
30	sales	110,000		24	Wages	10,000	
				24	Bank-c	60,000	
				30	Transport		32,000
				30	Net Repa		80,000
				30	Transport		15,000
					Bal c/d	265,000	93,000
		605,000	300,000			605,000	300,000
1 Oct		265,000	93,000				

NB: Cash paid into the bank is shown as payment in the cash account and a receipt in the bank account. All payments of money by cash or cheque into the bank are entered on the debit side of the bank account.

All withdrawals of cash or payments for instance repairs to nets, transport made by cheques are entered on the credit side of bank account. Some entries are found in both debit and credit sides of the cash book. For instance, entries on 2nd , 17th and 24th September are found on the debit side of the bank account and credit side of the cash account, such entries are called contra entries which means opposite or against. In other words, contra are shown by the letter C at the end of the entry..

Contra entries are possible where:

a. Cash is taken out of cash account and has been put in the bank.
b. Cash drawn from the bank to boost the amount of cash in the till.

PETTY CASH PAYMENT JOURNAL

- Petty Cash Payment Journal is maintained in order to record minor payments in an entity. Some examples of Petty expenses include the following
  a. Entertainment expenses
  b. Purchase of stamps and envelops
  c. Purchase of file covers
  d. Cost of purchasing a pen
  e. Cost of travel

- The original document used to make entries in the Petty Cash Payment Journal is **Petty Cash Payment Voucher.**
- The likely total cost of such expenses for a given period is decided in advance and the Chief Casher will give that sum to a Petty Cashier. This sum of money is known as the Petty Cash Imprest and that the reimbursement of the expenses to the Petty Cashier is known as the Imprest system.

GENERAL JOURNAL

- The Journal where entries that are not entered in the Books of prime entry are made is introduced as the General Journal or Main Journal.
- The source document used to make entries in the General Journal is the **Journal Voucher.**

RULES OF DOUBLE ENTRY

THE ACCOUNTS FOR DOUBLE ENTRY

- Each account should be shown on a separate page in the accounting books. The double entry system divides each page into two halves.
- The left-hand side of each page is called the **debit** side, while the right-hand side is called the **credit** side. The title of each account is written across the top of the account at the centre.

Accounts	To record	Entry in the account
Assets	an increase	Debit
	a decrease	Credit
Liabilities	an increase	Credit
	a decrease	Debit
Capital	an increase	Credit
	a decrease	Debit
Expenses	An increase	Debit
	A decrease	Credit
Revenues	An increase	Credit
	A decrease	Debit
Losses	An increase	Debit
	A decrease	Credit entry

- The double entry follows the rules of the accounting equation.
- The double entry maintains the principle that every debit has a corresponding
- credit entry
- Each account should be shown on a separate page in the accounting books.
- The double entry system divides each page into two halves. The left-hand side of each page is called the **debit** side, while the right-hand side is called the **credit** side.
- Each transaction is entered twice. In an accounting transaction, something always **'gives'** and something **'receives'** and both aspects of the transaction must be recorded. In other words, there is a double entry in the accounting books – each transaction is entered twice.

- The title of each account is written across the top of the account at the centre.
- This is the layout of a page of an accounts book:

Title of account written here

Left-hand side of the page	*Right-hand side of the page*
This is the **'debit' side**.	This is the **'credit' side**.

- To **increase** an **asset** we make a DEBIT entry
- To **decrease** an **asset** we make a CREDIT entry
- To **increase** a **liability/capital** account we make a CREDIT entry
- To **decrease** a **liability/capital** account we make a DEBIT entry.

STOCK MOVEMENTS

The following are the names of accounts that are opened involving movement of goods

- **A Purchases Account** – in which purchases of goods are entered; and
- **A Returns Inwards Account** – in which goods being returned in to the business are entered. (This is also known as the **Sales Returns Account**.)
- **A Sales Account** – in which sales of goods are entered; and
- **A Returns Outwards Account** – in which goods being returned out to a supplier are entered. (This is also known as the **Purchases Returns Account**.)

PURCHASE OF STOCK ON CREDIT

PURCHASING GOODS ON CREDIT

- The asset of stock is increased. An increase in an asset needs a debit entry in an account. Here the account is one designed for this type of stock movement. It is clearly a 'purchase' movement so that the account to use must be the purchases account.
- In accounting, the term 'purchases' refers to purchases of stocks. Acquisitions of any other assets, such as vans, equipment and buildings, are *never* described as purchases.
- There is an increase in a liability. This is the liability of the business to creditor because the goods bought have not yet been paid for. An increase in a liability needs a credit entry. In this case, it would be a credit entry to creditor's account. The purchases on credit are *always* entered in the supplier's (creditor's) account.
- Set of entries for the purchase of goods on credit can be broken down into two stages: first, the purchase of the goods, and second, the payment for them.

  The first part is:

  a. **Debit the purchases account**

  b. **Credit the supplier's account.**

  The second part is:

  a. **Debit the supplier's account**

  b. **Credit the cash account.**

  SPECIAL MEANING OF 'SALES' AND 'PURCHASES'

- **Purchases** in accounting means the ***purchase of those goods which the business buys with the prime intention of selling***. If something else is bought ***which the business does not intend to sell***, such as a van, such an item cannot be called **'purchases'**, even though in ordinary language you would say that a van has been purchased. The prime intention of buying the van is for usage and *not* for resale.
- Similarly, **sales** means the ***sale of those goods in which the business normally deals and which were bought with the prime intention of resale.*** The word **'sales'** must never be given to the disposal of other items, such as vans or buildings that were purchased to be used and ***not*** to be sold.

PURCHASES OF STOCK FOR CASH

Purchasing goods and cash being paid for them immediately at the time of purchase

- It is the asset of stock that is increased, so a debit entry will be needed. The movement of stock is that of a 'purchase', so the purchases account needs to be debited.
- The asset of cash is decreased. To reduce an asset a credit entry is called for and the asset is cash, so we need to credit the cash account.
- When goods are purchased for cash, the entries are:
  a. **Debit the purchases account**
  b. **Credit the cash account.**
- NB-With cash purchases, no entry is made in the supplier's account. This is because cash passes immediately and therefore there is no need to keep a check of how much money is owing to that supplier.
  On the other hand, with credit purchases, the records should show to whom money is owed until payment is made and so an entry is always made in the supplier's (creditor's) account.

SALES OF STOCK ON CREDIT

- An asset account is increased. The increase in the asset of debtors requires a **debit** and the debtor, so that the account concerned is that of **Debtor's account**. The sales on credit are ***always*** entered in the **customer's (debtor's)** account.
- The asset of stock is decreased. For this **a credit entry** to reduce an asset is needed. The movement of stock is clearly the result of a 'sale' and so it is the **sales account** that needs to be credited.
- A sales account is used to record sales of stock (as credit entries in the Account) and that a returns outwards account is used to record stock returned to suppliers (as credit entries in the account).

SALES OF STOCK FOR CASH

When goods are sold on cash basis, cash being received immediately at the time of sale.

- The **asset of cash is increased**, so the **cash account must be debited.**
- The **asset of stock is reduced**. The reduction of an asset requires a credit and the movement of stock is represented by **'sales'**. Thus the entry needed is **a credit in the sales account**

Examples of Revenue Accounts

a. Subscriptions Account
b. Rent Receivable Account
c. Account Royalties Receivable Account

RETURNS INWARDS

When goods which had been previously sold to the customer are now returned *to the business.*

- The **asset of stock is increased by the goods returned**. Thus, a debit representing an increase of an asset is needed. This time, the movement of stock is that of **'returns inwards'**. The entry required is a **debit** in **the *Returns Inwards Account*.**
- There is **a decrease in an asset**. The debt of customer, the debtor to the business is now reduced. A **credit** is needed in **Debtor's account** to record this.

Returns outwards

When goods previously bought are returned ***by the business* to supplier/creditor.**

- The **liability** of the business to **creditor is decreased** by the value of the goods returned. The decrease in a liability needs **a debit**, this time in **creditor's account.**
- The **asset of stock is decreased by the goods sent out**. Thus, a **credit** representing **a reduction in an asset** is needed. The movement of stock is that of **'returns outwards'** so the entry will be a credit in the ***Returns Outwards Account***.

DOUBLE ENTRIES FOR EXPENSES AND REVENUES

1. Rent of K200 is paid in cash.

Here the twofold effect is:

a. The total of the expenses of rent is increased. As expense entries are shown as debits, and the expense is rent, the action required is to debit the rent account with K200.
b. The asset of cash is decreased. This means the cash account must be credited with K200 to show the decrease of the asset.

Summary: Debit the *rent account* with K200.
Credit the *cash account* with K200.

2. Motor expenses of K355 are paid by cheque.

The twofold effect is:

a. The total of the motor expenses paid is increased. The amount in expense accounts is increased through debit entries, so the action required is to debit the motor expenses account with K355.
b. The asset of funds in the bank is decreased. This means the bank account must be credited with K355 to show the decrease of the asset.

Summary: Debit the *motor expenses account* with K355.
Credit the *bank account* with K355.

3. K60 cash is received for commission earned by the business.

- The asset of cash is increased. This needs a debit entry of K60 in the cash account to increase the asset.
- The revenue account, commissions received, is increased. Revenue is shown by a credit entry, so, to increase the revenue account, the commissions received account is credited with K60.

Summary: Debit the *cash account* with K60.
Credit the *commissions received account* with K60.

Some examples of expense accounts.

- Rent Account
- Postages Account
- Carriage outwards
- Business rates account
- Sundry expenses
- Bad debts account
- Commissions Account
- Stationery Account
- Wages Account
- Insurance Account
- Bank Interest Account
- Motor Expenses Account
- Telephone Account
- General Expenses Account
- Overdraft Interest Account
- Audit Fees Account

EXAMPLES ON DOUBLE ENTRIES

1 Started in business with K5, 000 in the bank and K1, 000 cash.

- 2 Bought stationery by cheque £75.
- 3 Bought goods on credit from T Smart £2,100.
- 4 Sold goods for cash K340.
- 5 Paid insurance by cash K290.
- 7 Bought a computer on credit from J Hott K700.
- 8 Paid expenses by cheque K32.
- 10 Sold goods on credit to C Biggins K630.
- 11 Returned goods to T Smart K550.
- 14 Paid wages by cash K210.
- 17 Paid rent by cheque K225.
- 20 Received cheque K400 from C Biggins.
- 21 Paid J Hott by cheque K700.
- 23 Bought stationery on credit from News Ltd K125.
- 25 Sold goods on credit to F Tank K645.
- 31 Paid News Ltd by cheque K125.

Workings

Transactions	DR	CR
• **Started in business with K5, 000 in the bank and**		

K1, 000 cash		
Account Name: Bank Account Account name : Capital account	K5,000	K5,000
• **2 Bought stationery by cheque K75.**		
Account Name: Stationary Account Account name : Bank account	K5,000	K5,000
• **3 Bought goods on credit from T Smart K2,100.**		
Account Name: Purchase Account Account name : Creditor's account ,T Smart	K2,100	K2,100
• **4 Sold goods for cash K340.**		
Account Name: Cash Account Account name : Sales account	K340	K340
• **5 Paid insurance by cash K290.**		
Account Name: Insurance Account Account name : Cash account	K290	K290
• **7 Bought a computer on credit from J Hott K700.**		
Account Name: Computer Account Account name :Creditor's account : J Hott	K700	K700
• **8 Paid expenses by cheque K32.**		
Account Name: Expense Account Account name : Bank account	K32	K32
• **10 Sold goods on credit to C Biggins K630.**		
Account Name: Debtor's Account : C. Biggins Account name : Sales account	K630	K630
• **11 Returned goods to T Smart K550.**		
Account Name: Creditor's Account : T. Smart Account name : Returns Outward account	K550	K550
• **14 Paid wages by cash K210.**		
Account Name: Wages'Account Account name : Cash account	K210	K210
• **17 Paid rent by cheque K225.**		
Account Name: Rent Account Account name : Bank account	K225	K225
• **20 Received cheque K400 from C Biggins.**		
Account Name: Bank Account Account name : Debtor's account : C. Biggins	K400	K400
• **21 Paid J Hott by cheque K700.**		
Account Name: Creditor's Account " J.Hott Account name : Bank account	K700	K700
• **23 Bought stationery on credit from News Ltd K125.**		
Account Name: Stationery Account Account name : Creditor's account	K125	K125
• **25 Sold goods on credit to F Tank K645.**		
Account Name: Debtor's Account	K645	

Account name : Sales account.		K645
• **31 Paid News Ltd by cheque K125.**		
Account Name: Creditor's Account	K125	
Account name : Bank account		K125

DRAWINGS

- Sometimes the owners will want to take cash out of the business for their private use. This is known as **drawings**. Any money taken out as drawings will reduce capital. Drawings are never expenses of a business. However, like expenses, an increase in drawings is a debit entry in the drawings account, with the **credit being against an asset account, such as cash or bank.**
- In theory, the debit entry should be made in the **capital account** (as **drawings decrease capital).**
- However, to prevent the capital account becoming full of lots of small transactions, drawings are not entered in the capital account. Instead, a ***drawings account*** is opened, and the debits are entered there rather than in the capital account.

TYPES OF ACCOUNTS

Some people describe all accounts as personal accounts or as impersonal accounts.

1. **Personal Accounts** – these are for debtors and creditors (i.e. customers and suppliers).
2. **Impersonal Accounts** – divided between 'real' accounts and 'nominal' accounts:
   a. **Real Accounts** – accounts in which possessions are recorded. Examples are buildings, machinery, fixtures and stock.
   b. **Nominal Accounts** – accounts in which expenses, income and capital are recorded.

DEPRECIATION OF ASSETS

What is depreciation?

- Depreciation of refers to the part of the original cost of the fixed asset consumed during its period of use by the business. It is an expense charged to the profit and loss account reducing the net profit.
- Depreciation is also defined as the reduction in value of non-current assets due to various factors and wear and tear being one of them.
- The cost price of the non- current asset is referred as **BOOK VALUE** and when it comes to the end its useful life will usually have some remaining value which is called **RESIDUAL VALUE OR SCRAP VALUE.**

CAUSES OF DEPRECIATION.

1. **Wear and tear-** This means fixed assets wear out in value as they are used by the company.
2. **Erosion- Some assets depreciate due to rusting, rotting or decaying.**
3. **Obsolescence-** Some fixed assets become out of fashion
4. **Inadequacy-** the asset is no longer used because of the growth and changes in the size of the firm

5. **Lapse of time of lease-** this means that when the years are finished, the lease is worth nothing

METHODS OF CALCULATING DEPRECIATION

The two methods used in calculating depreciation are

a. The straight line method/fixed installment method
b. Reducing balance method

THE STRAIGHT LINE METHOD

- This is where the percentage charge for depreciation is ascertained and based on the original cost value of the asset.
- In this method, the number of years of use is also estimated. The cost is then divided into the number of years which gives the depreciation charges for each year.
- Straight line method is calculated using the formula

Annual depreciation charge $= \frac{\text{Book Value} - \text{Scrap Value}}{\text{Expected Life in Years.}}$

Example 1

Target Secondary School bought a computer for K40, 000 in January, 2014 and that depreciation was set to be charged at 20% straight line, ascertain the depreciation calculations for three years and its value after three years.

SOLUTION

Cost price of the computer Less provision for depreciation 1st year Cost of computer after 1st year	K40,000 20% x K40,000 = K8,000 K40,000- K8,000 =K32,000
Cost of computer at beginning of 2nd year Less provision for depreciation 2nd year Cost of computer at the end of 2nd year	K32,000 20% X K40,000 = K8,000 K32,000- K8,000 = K24,000
Cost of computer at the beginning of 3rd year Less provision for depreciation 3rd year Cost of computer after 3rd year	**K24,000** 20% X K40,000 = K8,000 K24,000- K8,000 = K16,000 K16,000

Example 2

A motor vehicle is purchased for K8, 750,000 on 1st January, 2022. It is estimated that it will need replacing in four years and will then fetch K1, 250,000 as its scrap value. Find the annual depreciation charge.

Workings

Annual depreciation charge $= \frac{\text{Book Value} - \text{Scrap Value}}{\text{Expected Life in Years.}}$

Annual depreciation charge $= \frac{K8{,}750{,}000 - K1{,}250{,}000}{4}$

= K1, 8750,000

A motor vehicle is purchased for K8, 750,000 on 1st January, 2022. It is estimated that it will need replacing in four years and then motor vehicle will have no disposal value. Find the annual depreciation charge.

Workings

Annual depreciation charge $= \frac{\text{Book Value} - \text{Scrap Value}}{\text{Expected Life in Years.}}$

Annual depreciation charge = $\frac{K8,750,000-}{4}$

= **K2, 187,000**

REDUCING BALANCE/DIMINISHING BALANCE METHOD

This is used where the percentage charge for depreciating the fixed asset is determined and calculate depreciation based on the current 'Net Book Value' balance for each year.

EXAMPLE 1

Show the depreciation calculations using reducing balance method for the computer that was bought for K6, 000,000 and that depreciation charge was fixed at 40% per annum. Hence find the residual value of the computer after three years.

Workings

Cost price of the computer Less provision for depreciation 1st year Cost of computer after 1st year	K6,000,000 40% x K40,000 = K2,400,000 K6,000,000- K2,400,000 =K3,600,000
Cost of computer at beginning of 2nd year Less provision for depreciation 2nd year Cost of computer at the end of 2nd year	K3,600,000 20% X K3,600,000 = K1,440,000 K3,600,000- K1,440,000 = K2,160,000
Cost of computer at the beginning of 3rd year Less provision for depreciation 3rd year Cost of computer after 3rd year	K2,160,000 20% X K2,160,000 = K864,000 K2,160,000- K864,000 = K1,296,000

Example 2

A machine is bought for K10, 000,000 and depreciation is to be charged at 20% per annum for three years using diminishing balance method. Find the value of the machine after 3 years.

Workings

Cost price Less 1st year depreciation at 20% Value of the machine after 1st year	K10,000,000 K2,000,000 K8,000,000
Value of the machine at the start of 2nd year Less 2nd year Depreciation at 20% Value of machine after 2nd year	K8,000,000 K1,600,000 K6,400,000
Value of machine at the start of 3rd year Less : 3rd year Depreciation at 20% Value of machine after 3rd year	K6,400,000 K1,280,000 K5,120,000

The total depreciation for the 3 years will be obtained by the formula

Depreciation = Book Value – Scrap Value

= K10, 000,000 – K5, 120,000

= K4, 880,000

DOUBLE ENTRY SYSTEM FOR DEPRECIATION

Three accounts are opened in respect to the double entry records for depreciation. These are

a. Asset account

b. Profit and loss account

c. Provision for depreciation account

The double entry is

- Debit- profit and loss account
- Credit- provision for depreciation account

EXAMPLE

Suppose in a business with financial year ending 31 December, 2014, a motor van was bought for K3, 000,000. Depreciation is agreed to be set at 30% pa straight line.

Required.

Prepare

a. Asset account

b. Provision for depreciation account

c. Profit and loss account

d. Balance sheet

MOTOR VAN ACCOUNT

DATE	DETAILS	AMOUNT	DATE	DETAILS	AMOUNT
2014 Jan 1	Bank	K 3,000,000	2014		K

DR PROVISION FOR DEPRECIATION A/C-MOTOR VAN CR

DATE	DETAILS	AMOUNT	DATE	DETAILS	AMOUNT
2014 Dec 31 2015	Balance c/d	K 900,000	2014 Dec 31 2015	Profit & loss	K 900,000
			Jan 1	Balance b/d	900,000
Dec 31 2016	Balance c/d	1,800,000 1,800,000	2015 Dec 31 2016	Balance b/d Profit & loss Balance b/d	900,000 900,000 1,800,000 1,800,000
2016 Dec 31 2017	Balance c/d	2,700,000 2,700,000	Dec 31 2017 Jan 1	Profit & loss Balance b/d	900,000 2,700,000 K2,700,000

PROFIT AND LOSS ACCOUNT

DATE	DETAILS	AMOUNT	DATE	DETAILS	AMOUNT
2014 Dec 31	Depreciation	K 900,000			
2015 Dec 31	Depreciation	K 900,000			

2016 Dec 31	Depreciation	K 900,000			

BALANCE SHHET EXTRACT

AS AT 31 DECEMBER, 2014	K	K
Motor van at cost	3,000,000	
Less depreciation to date	900,000	2,100,000
AS AT 31 DECEMBER 2015		
Motor van at cost	3,000,000	
Less depreciation to date	1,800,000	1,200,000
AS AT 31 DECEMBER 2016		
Motor van at cost	3,000,000	
Less depreciation to date	2,700,000	300,000

TRIAL BALANCE

- A trial balance is a book keeping worksheet in which the balances of all ledgers are compiled into debit and credit account column totals that are equal.
- The purpose of producing trial balance is to ensure that entries in the company's book keeping system are mathematically correct. Preparing a trial balance for a company serves to detect any mathematical errors that have occurred in the double accounting system. If the total debits equal the total credits, the trial balance is considered to be balanced, and there should be no mathematical errors in the ledgers. A company prepares trial balance at the end of every reporting period. A trial balance may be drawn up at the end of accounting period, six months period or a year period. To extract a trial balance, all the individual accounts must be balanced off in the ledgers
- Double entry book keeping demands that for every debit entry, there must be its corresponding credit entry and vice versa. This means that all the accounts on the debit side should be equal in total with all the accounts recorded on the credit side. To check this arithmetic accuracy, a trial balance is used.
- Therefore, a trial balance is the list of all debit balances on one side and all credit balances on the other side. When balances are added together, the figure should match the summation of all credit balances to those of debit balances.

RULES OF TRIAL BALANCE

1. All assets must be on the debit side.
2. All expenses and losses must be on the debit side.
3. Drawings must be on the debit side.
4. All liabilities must be on the credit side.
5. All income and gain must be on the credit side.
6. Drawings must be on the debit side.

TRIAL BALANCE ITEMS LIST

The list of debit and credit items in the trial balance is as follows

1. The debit side of the trial balance feature entries from accounts like assets, drawing accounts, cash balance, bank balance, losses, purchases account, sundry debtors and expense accounts.
2. The credit side of the trial balance will feature entries from liabilities, capital accounts, income accounts, sales, sundry creditors, gains and reserves.

Rules to prepare the trial balance are an equation which is as follows:

Total Debit Entries = Total Credit Entries

DEBIT SIDE	CREDIT SIDE
• All assets such as cash in hand, cash at bank, land buildings, plant and machinery etc. • Sundry debtors • Expenses such as carriage inwards, rent, wages and salaries, motor expenses, commission paid, insurance, advertising etc. • Losses such as depreciation, returns inwards, bad debts etc	• All liabilities such as bank overdraft, bills payable, outstanding bills, loan mortgage etc. • Sundry creditors • Reserve fund, general reserves, provision for depreciation, accumulated depreciation etc. • Sales • Gains such as discount received, returns outwards • Bad debts recovered etc

STEPS TO PREPARE TRIAL BALANCE

The following are the steps to prepare trial balance:

1. **Step 1 :** Balance all the ledger accounts in the books
2. **Step 2 :** List all the debit balances on the debit side and sum them up
3. **Step 3 :** List all the ~~debit~~ Credit balances on the debit side and sum them up

Ideally, the trial balance should tally at the step 3.

PREPARATION OF TRIAL BALANCE

Record the following details relating to Chapeti , a retailer into relevant different accounts and prepare the trial balance.

The accounts are for the month of November, 2021.

1	Started business with K20,000 in the bank.	
3	Bought goods on credit from the following people J. Small F. Brown T. Rae R. Charles	 K290,000 K1,200,000 K619,000 K530,000
5	Cash sales	K610,000
6	Paid rent by cheque	K175,000
7	Paid business rates by cheque	K130,000
11	Sold goods on credit to T. Poti J. Field	 K850,000 K48,000

	T. Gray	K1,640,000
17	Paid wages by cash	K290,000
18	We returned goods to J. Small R. Charles	 K18,000 K27,000
19	Bought goods on credit from R. Charles T. Rae F. Jack	 K110,000 K320,000 K165,000
20	Goods were returned to us by J. Field T. Poti	 K6,000 K14,000
21	Bought a Van on a credit from A.M. Motors	K4,950,000
23	We paid the following by cheque immediately J. Small F. Brown t. Rae	 K272,000 K1,200,000 K500,000
25	Bought another Van paying by cheque immediately	K6,200,000
26	Received a loan from B. Bennet	K750,000 Cash
28	Received cheques from T. Poti j. Field	K71,000 K42,000
30	Proprietor brings a further K900,000 into the business by payment into the bank account	

Capital Account

Date	Details	Amount (K)	Date	Details	Amount(K)
30	Balance c/d	20,900,000	1 30	Bank Bank	20,000,000 900,000
		20,900,00			**20,900,000**
			1/10	Bal b/d	20,900,000

Bank Account

Date	Details	Amount (K)	Date	Details	K
1	Capital	20,000,000	6	Rent	175,000
28	T. Poti	71,000	7	Business rate	130,000
28	Field	42,000	23	J. Small	272,000
30	Capital	900,000	23	F. Brown	1,200,000
			23	T. Rae	500,000
			25	Van	6,200,000
			30	Bal c/d	12,536,000
		21,013,000			**21,013,000**
1/10	Bal b/d	12,536,000			

Creditor Account: J. Small

Date	Details	(K)	Date	Details	Amount(K)
18	Retur Outward	18,000	3	Purchases	290,000
23	Bank	272,000			

		290,000			290,000

Creditor-Frown

Date	Details	Amount (K)	Date	Details	Amount(K)
23	Bank	1,200,000	3	Purchases	1,200,000
		1,200,000			**1,200,00**

Creditor-T- Rae

Date	Details	Amount (K)	Date	Details	Amount(K)
23	Bank Bal c/d	500,000 430,000	3 19	Purchases Purchases	610,000 320,000
		930,000			**930,000**
			1/10	Bal b/d	430,000

Creditor-Charles

Date	Details	K	Date	Details	Amount(K)
18 30	Returns Outward Bal c/d	27,000 613,000	3 19	Purchases Purchases	530,000 110,000
		640,000			**640,000**
			1/10	Bal b/d	613,000

Creditor Account-F. Jack

Date	Details	K	Date	Details	Amount(K)
30	Bal c/d	165,000	19	Purchases	165,000
		165,000			**165,000**
			1/10	Bal b/d	165,000

Creditor Account: A.M. Motors

Date	Details	K	Date	Details	Amount(K)
30	Bal c/d	4,950,000	21	Purchases	4,950,000
		4,950,000			**4,950,000**
			1/10	Bal b/d	4,950,000

Creditor Account: B. Bennet

Date	Details	K	Date	Details	K
30	Bal c/d	750,000	26	Cash	750,000
		750,000			**750,000**
			1/10	Bal b/d	750,000

Purchases Account

Date	Details	Amount (K)	Date	Details	Amount(K)
3	J. Small F. Brown T. Rae R. Charles	290,000 1,200,000 610,000 530,000	30	Bal c/d	3,225,000
19	R. Charles	110,000			
19	T. Rae	320,000			
19	F. Jack	165,000			
		3,225,000			**3,225,000**
1/10	Bal b/d	3,225,000			

Cash Account

Date	Details	Amount (K)	Date	Details	Amount(K)
5	Sales	610,000	17	Wages	290,000
26	A.M. Motors	750,000	30	Bal c/d	1,070,000
		1,360,000			**1,360,000**
1/10	Bal b/d	1,070,000			

Sales Account

Date	Details	K	Date	Details	Amount(K)
	Bal c/d	3148,000	5	Cash	610,000
			11	T. Poti	850,000
			11	J. Field	48,000
			11	T. Gray	1,640,000
		3148,000			**3,148,000**
			1/10	Bal b/d	3148,000

Rent Account

Date	Details	Amount (K)	Date	Details	Amount(K)
6	Bank	175,000	30	Bal c/d	175,000
		175,000			**175,000**
1/10	Bal b/d	175,000			

Business Rates Account

Date	Details	Amount (K)	Date	Details	Amount(K)
7	Bank	130,000	30	Bal c/d	130,000
		130,00			**130,000**
1/10	Bal b/d	130,000			

Debtors: T. Poti

Date	Details	K	Date	Details	Amount(K)
11	Sales	850,000	20	Returns In	14,000
			28	Bank	71,000
				Bal c/d	765,000
		850,00			**850,000**
	Bal b/d	765,000			

Debtors: J. Field

Date	Details	K	Date	Details	K
11	Sales	48,000	20	Returns in	6,000
			28	Bank	42,000
		48,000			48,000

Debtors: T. Gray

Date	Details	Amount (K)	Date	Details	Amount(K)
11	Sales	1,640,000	30	Bal c/d	1,640,000
		1,640,000			**1,640,000**
1/10	Bal b/d	1,640,000			

Wages Account

Date	Details	Amount (K)	Date	Details	Amount(K)
17	Cash	290,000	30	Bal c/d	290,000
		290,000			**290,000**

1/10	Bal b/d	290,000			

Returns Outward Account

Date	Details	K	Date	Details	K
30	Bal c/d	45,000	18 18	J. Small R. Charles	18,000 27,000
		45,000			45,000
			1/10	Bal b/d	45,000

Returns Inward Account

Date	Details	K	Date	Details	Amount(K)
20 20	J. Field T. Poti	6,000 14,000	30	Bal c/d	20,000
		20,000			20,000
1/10	Bal b/d	20,000			

Van Account

Date	Details	K	Date	Details	Amount(K)
21 25	A.M. Motors Bank	4,950,000 6,200,000	30	Bal c/d	11,150
		11,150,000			**11,150,000**
1/10	Bal b/d	11,150,000			

TRIAL BALANCE AS AT 30STH SEPTEMBER, 2022

ACCOUNTS	DR	CR
Capital		20,900,000
Bank	12,536,000	
Cash	1,070,000	
Van	11,150,000	
Returns outwards		45,000
Wages	290,000	
Rent	175,000	
Business rates	130,000	
Sales		3,148,000
Returns inwards	20,000	
Purchases	3,225,000	
Debtors • T. Poti • T. Gray	 765,000 1,640,000	
Creditors • T Rae • R. Charles • F. Jack • A.M. Motors • B. Bennet		 430,000 613,000 165,000 4,950,000 750,000
	31,001,000	**31,001**

ERRORS THAT DO NOT AFFECT TRIAL BALANCE

a. Original errors entry

These originate from errors in the original entries. For example taking an invoice for K2, 050 and entering it as K2, 500 in the purchase book.

b. Errors of omission

This occurs when a supposed entry is omitted completely from the books and appears on neither the debit nor credit side of the trial balance.

c. Errors commission

These are errors in the actual performance of an operation like posting. For example, if J. Chikapa is debited instead of T. Chikapa the trial balance will not be affected.

d. Errors of principle

This is an error that offends against the basic ideas of bookkeeping which involving recording the purchase current assets as if they are non-current assets since their recording is not the same

e. Compensating errors

These usually arise bad arithmetic.

WORKED EXAMPLES

1. The following information relates to the business transactions of Zanga Business Enterprise as at 31st December, 2020.

Accounts	Balances (K)
Sales	190,576
Purchases	119,832
Salaries	56,527
Motor expenses	2,416
Rent	1,894
Insurance	372
General expenses	85
Premises	95,420
Motor vehicles	16,594
Debtors	26,740
Creditors	16,524
Cash at bank	16,519
Cash in hand	342
Drawings	8,425
Capital	138,066

Prepare the trial balance as at 31st December, 2020.

TRIAL BALANCE AS AT 31ST DECEMBER, 2020

Accounts	DR	CR
Sales		190,576
Purchases	119,832	
Salaries	56,527	
Motor expenses	2,416	

Rent	1,894	
Insurance	372	
General expenses	85	
Premises	95,420	
Motor vehicles	16,594	
Debtors	26,740	
Creditors		16,524
Cash at bank	16,519	
Cash in hand	342	
Drawings	8,425	
Capital		138,066

2. The following information relates to the business transactions of **ZAIFA** Business Enterprise as at 31st December, 2020.

Sales	265,900
Purchases	154,870
Rent	4,200
Lighting and heating expenses	530
Salaries and wages	51,400
Insurance	2,100
Buildings	85,000
Fixtures	1,100
Debtors	31,300
Sundry expenses	412
Creditors	15,910
Cash at bank	14,590
Drawings	30,000
Vans	16,400
Motor running expenses	4,110
Capital	114,202

Prepare the trial balance as at 31st December, 2020

PREPARATION OF TRIAL BALANCE AS AT 31ST DEC, 2020

	DR	CR
Sales		265,900
Purchases	154,870	
Rent	4,200	
Lighting and heating expenses	530	
Salaries and wages	51,400	
Insurance	2,100	
Buildings	85,000	
Fixtures	1,100	
Debtors	31,300	
Sundry expenses	412	

Creditors		15,910
Cash at bank	14,590	
Drawings	30,000	
Vans	16,400	
Motor running expenses	4,110	
Capital		114,202

3. The following information relates to the business transactions of **NDEKHA** Business Enterprise as at 31st December, 2020..

General expenses	305
Business rates	2,400
Motor expenses	910
Salaries	39,560
Insurance	1,240
Purchases	121,040
Sales	235,812
Car	4,300
Creditors	11,200
Debtors	21,080
Premises	53,000
Cash at bank	2,715
Cash in hand	325
Capital	23,263
Drawings	23,400

Prepare the trial balance as at 31st December, 2020

4. The following information relates to the business transactions of **Azakufa** Business Enterprise as at 31st December, 2020.

	DR	CR
General expenses	305	
Business rates	2,400	
Motor expenses	910	
Salaries	39,560	
Insurance	1,240	
Purchases	121,040	
Sales		235,812
Car	4,300	
Creditors		11,200
Debtors	21,080	
Premises	53,000	
Cash at bank	2,715	
Cash in hand	325	
Capital		23,263
Drawings	23,400	

Prepare the trial balance as at 31st December, 2020

5. The following information relates to the business transactions of **ZENGO** Business Enterprise as at 31st December, 2020

Equipment rental	940
Insurance	1,804
Lighting and heating expenses	1,990
Motor expenses	2,350
Salaries and wages	48,580
Sales	382,420
Purchases	245,950
Sundry expenses	624
Lorry	19,400
Creditors	23,408
Debtors	44,516
Fixtures	4,600
Shop	174,000
Cash at bank	11,346
Drawings	44,000
Capital	194,272

Prepare the trial balance as at 31st December, 2020

LIST OF ACCOUNTS	DR	CR
Equipment rental	940	
Insurance	1,804	
Lighting and heating expenses	1,990	
Motor expenses	2,350	
Salaries and wages	48,580	
Sales		382,420
Purchases	245,950	
Sundry expenses	624	
Lorry	19,400	
Creditors		23,408
Debtors	44,516	
Fixtures	4,600	
Shop	174,000	
Cash at bank	11,346	
Drawings	44,000	
Capital		194,272

PREPARATION OF BALANCE SHEET

BALANCE SHEET

Define the term balance sheet. It is the financial statement that contains the details of assets, liabilities and capital of the business.

The balance sheet is presented in the form of different headings for assets, liabilities and capital

COMPONENTS OF THE BALANCE SHEET

1. FIXED ASSETS

Fixed assets are assets that

- Were not bought primarily to be sold; but
- Are to be used in the business; and
- Are expected to be of use to the business for a long time.

Examples: buildings, machinery, motor vehicles, fixtures and fittings.

Fixed assets are listed first in the balance sheet starting with those the business will keep the longest, down to those which will not be kept so long. For instance

a. Land and buildings
b. Fixtures and Fittings
c. Machinery
d. Motor Vehicles

2. CURRENT ASSETS

- **Current assets** are assets that are likely to change in the short term and certainly within twelve months of the balance sheet date. They include items held for resale at a profit, amounts owed by debtors, cash in the bank, and cash in hand.
- These are listed in increasing order of liquidity. That is, starting with the asset furthest away from being turned into cash, finishing with cash itself. For instance
  a. Stock
  b. Trade debtors
  c. Cash at the Bank
  d. Cash in Hand

3. CURRENT LIABILITIES

There are two categories of liabilities, current liabilities and long-term liabilities.

CURRENT LIABILITIES

Current liabilities are items that have to be paid within a year of the balance sheet date.

Examples: bank overdrafts, amounts due to creditors for the purchase of goods for resale.

LONG-TERM LIABILITIES

Long-term liabilities are items that have to be paid more than a year after the balance sheet date.

Examples: bank loans, loans from other businesses.

4. WORKING CAPITAL

Working capital = Total current assets – Total Current Liabilities

5. CAPITAL

- This is the monetary value of an enterprise at a specific time. It consists of fixed capital for fixed assets and working capital for current assets. Some of the working capital will be in the business permanently. While other working capital will be needed to fund fluctuating levels of current assets needed to sustain short-term increases in requirements.

- The capital side of balance sheet compromises initial capital, net profit and drawings
- Net profits is added to the capital in the balance sheet
- Drawings refer to goods or cash taken from business for private usage by the owner.
- In the balance sheet, drawings are presented as a deduction from capital.

PREPARATION OF BALANCE SHEET

1. The following information relates to the business transaction for Build Mat Business Enterprise for the year ending 31st December, 2019.

Fixtures and fittings	5,000
Debtors	6,800
Capital	20,000
Net profit for the year	8,000
Stock	3,000
Drawings	7,000
Bank	15,100
Cash	200
Creditors	9,100

Prepare the balance sheet as at 31st December, 2019.

WORKINGS

	K	K
Fixed assets		
Fixtures and fittings		5,000
Current assets		
Stock	3,000	
Debtors	6,800	
Bank	15,100	
Cash	200	
Total current assets	**25,100**	
Less Current liabilities		
Creditors	**(9,100)**	
Working capital (current assets – current liabilities)		16,000
Total assets		**21,000**
Capital		20,000
Add: Net Profit		8,000
Less Drawings		(7,000)
Net Worth		**21,000**

Working capital is the difference between total current assets and total current liabilities.

CURRENT RATIO

It is the ratio of current assets to current liabilities and it is concerned with the organization of working capital as to whether it is being managed effectively.

Current ratio is also known as **Liquidity ratio**

Current ratio = $\frac{Current\ assets}{Current\ liabilities}$

NB: The higher the ratio of current assets to current liabilities, the higher the amount of working capital in the business. The higher the ratio, therefore, the safer is the business. A typical business should have a current ratio between **1.5 and 2.1 to 1**. If it is less than this the business runs the risk of not being able to pay bills and going out of business.

ACID TEST/QUICK RATIO

It examines the business's liquidity position or working capital by comparing current assets and liabilities but it omits stock from the total current assets. An ideal result for acid test ratio is between 1 to 1.

Acid Test Ratio = $\frac{Current\ assets - Stock}{Current\ liabilities}$

Example

The business has the following values of current assets and liabilities

	K(MILLION)
Cash	35.6
Debtors	75.2
Stock	51.8
Bank overdraft	3.9
Bank loans	4.7
Trade creditors	13.8
Other creditors	41.8

Required

Calculate

a. Working capital

b. Current ratio

c. Acid or quick ratio

Workings

a. Working capital

	K(MILLION)	
Cash	35.6	
Debtors	75.2	
Stock	51.8	
Total current assets		**162.7**
Bank overdraft	3.9	
Bank loans	4.7	
Trade creditors	13.8	
Other creditors	41.8	
Total current liabilities		**64.2**
Working capital		**98.5**

b. Current ratio = $\frac{162.7}{98.5}$

$= \mathbf{2.5:1}$

From the above example, the result shows that the business has **2.5** times current assets to current liabilities. This means that for every **K1 short term debts owed**, it has **2.5 times current assets** to pay them. The business is in very safe position as far as working capital is concerned.

c. **Acid test ratio** $= \frac{Current\ assets - Stock}{Current\ labilities}$

$= \frac{162.7-51.8}{64.2}$

$= \mathbf{1.7:1}$

The business is very safe with its acid test ratio which is the above the recommended 1:1.

PROBLEMS CAUSED BY INSUFFICIENT WORKING CAPITAL

14. The business will struggle to pay its bills on time.
15. If the business is resorting to borrowing, it will have additional cost of interest charges.
16. The business may not be able to buy supplies in bulk. This removes the advantage of lower bulk buying prices.

WAYS OF MANAGING WORKING CAPITAL

1. Controlling cash by minimizing stock levels, keeping customer credit as low as possible, negotiating for credit from suppliers and getting goods to the market in the shortest possible time.
2. Minimizing spending on fixed assets
3. Planning ahead by estimating needed cash.

TRADING ACCOUNT

- Trading account is a statement prepared by the business firm that shows gross profit of the business activities during a specific period.
- The trading account gives details of total sales, total purchases and direct expenses relating to purchases and sales.
- Trading account contains the following information:
  1. Opening stock details of raw materials, semi-finished goods and finished goods.
  2. Closing stock details of raw materials, semi- finished goods and finished goods.
  3. Total purchases of goods less Purchase Returns (Returns Outwards.
  4. Total Sales of goods less Sales Returns (Returns Inwards.
  5. All direct expenses related to purchases or sales such as carriage inwards.

MAIN ELEMENTS/COMPONENTS OF PROFIT AND LOSS A/C

1. **Revenue or Sales/ Turnover**

- This refers to revenue that the business realizes from selling its stock. The sales account and the **returns inwards account** deal with goods sold and goods returned by customers.

  Net Sales = Sales less Sales Returns/Returns Inwards

2. **Cost of Sales/Cost of Goods Sold**

- Cost of sales refers to the expenditure incurred by the business for the goods that have been sold.

- When calculating cost of goods sold, the following must be taken into consideration:

a. The purchases account and the **returns outwards account** deal with goods purchased and goods returned to the supplier respectively.

b. **Returns outwards** should be deducted to get the correct figure of purchases *kept* by the business organization. Both the purchase and returns accounts are included in the calculation of gross profit.

- **Closing stock** which is the is left at the end of the year. **Closing stock** must be subtracted from **purchases** to arrive at **cost of sales.**
  - This is calculated by the following formula
    a. Cost of Sales = Opening Stock + Purchases – Closing Stock
    b. Cost of Sales = Opening Stock + Purchases – Returns Outwards + Carriage Inwards – Closing Stock

3. Gross Profit

Gross Profit is the difference between Sales and the Cost of Sales. Gross profit is the excess of sales revenue over the **cost of goods sold**

Gross Profit is calculated as follows

Gross profit: Sales – Cost of Goods Sold

- Where the cost of goods sold is greater than the sales revenue, the result is a **gross loss.**

Cost of Goods Sold – Sales = Gross Loss

4. Expenses

These are other expenses incurred by the business for the day to day running of the business and include the following:

- Lighting and heating expenses
- Rent
- Discount allowed
- Carriage outwards
- General expenses
- Carriage outwards
- Salaries and wages
- Sundry expenses
- Wages and salaries
- Business rates
- Communication expenses
- Commissions paid
- Insurance
- Telephone charges
- Office expenses

5. Net Profit

Total figure for expenses is subtracted from gross profit to give the net profit.

Net Profit = Gross profit + rents received or commissions earned/discount received minus total trading/operating expenses used up during the period

Net Profit is what is left of the gross profit after all other expenses have been deducted.

PREPARATION OF TRADING ACCOUNT

2. From the following information, draw up the trading account of J Bell for the year ended 31 December 2017, which was his first year in business:

	K
Carriage inwards	980
Returns outwards	840
Returns inwards	1,290
Sales	162,918
Purchases	121,437

Stocks of goods: 31 December 2017 11,320

WORKINGS

	K	K
Sales	162,918	
Less: Returns inwards	(1,290)	161,628
Opening stock	0	
Add: Purchases	121,437	
Less: Returns outwards	840	
	120,597	
Add: carriage inwards	980	
	121577	
Less: closing stock	(11,320)	
Cost of sales		(110257)
Gross profit		51371

Cost of sales = Opening stock + Purchases−Rreturns outward + carriage inwards

−Closing stock

Gross profit = Sales − Cost of sales

3. The following information is available for the year ended 31 March 2018. Draw up the trading account of P Frank for that year.

	K
Stocks: 31 March 2018	52,400
Returns inwards	16,220
Returns outwards	19,480
Purchases	394,170
Carriage inwards	2,490
Sales	469,320

Workings

	K	K
Sales	469,320	
Less: Returns inwards	(16,220)	453,100
Opening stock	52,400	

Add: Purchases	394,170	
	446,570	
Less: Returns outwards	(19,480)	
	427,090	
Add: carriage inwards	2,490	
	429,580	
Less: closing stock	(0)	
Cost of sales		(429,580)
Gross profit		23,520

Cost of sales = Opening stock + Purchases–Closing stock

Gross profit = Sales – Cost of sale

4. From the following trial balance of Harry Investment, draw up a trading and profit and loss account for the year ended 30 September 2009, and a balance sheet as at that date.

	K
Creditors	9,000
Capital	31,000
Wages	5,200
Lighting and heating expenses	1,900
Opening stock	3,000
Rent	2,400
Bank	1,200
General expenses	700
Sales	67,000
Carriage outwards	1,100
Debtors	12,000
Cash	400
Purchases	42,600
Buildings	20,000
Fixtures and fittings	7,500
Stock	5,500
Drawings	9,000

Closing stock as at 30 September 2009 K5,500

Harry Investment

Trading and Profit and Loss Account for the year ending 30th September, 2009

	K	K
Sales		67,000
Opening stock	3,000	
Add: Purchases	42,600	
	45,600	
Less: Closing stock	5,500	
Cost of sales(Cost of goods sold) (45,600-5,500)		(40,100)
Gross profit		**26,900**

Less: expenses		
Wages		
Lighting and heating expenses	5,200	
Rent	1,900	
General expenses	2,400	
Carriage outwards	700	
Total expenses	1,100	
Net Profit for the Year		**(11,300)**
		15,600

Harry Investment

Balance sheet as at 30th September, 2009

Fixed assets (Non-current assets)	**K**	**K**
Buildings		
Fixtures and fittings	**20,000**	
Current assets	**7,500**	**27,500**
Stock(inventory) (closing stock)		
Trade debtors(Receivables)	**5,500**	
Bank	**12,000**	
Cash	**1,200**	
	400	
Less: Current liabilities	**19,100**	
Creditors		
Working capital(Current assets –Current liabilities)	**(9,000)**	
Total assets		**10,100**
Financed by		**37,600**
Capital		
Add: Profit for the year		31,000
		15,600
Less: Drawings		**46,600**
Total Net worth		**9,000**
		37,600

5. From the following trial balance of G Still, draw up a trading and profit and loss account for the year ended 30 September 20X9, and a balance sheet as at that date.

	Dr	*Cr*
	K	K
Stock 1 October 2018	41,600	
Carriage outwards	2,100	
Carriage inwards	3,700	
Returns inwards	1,540	
Returns outwards		3,410
Purchases	188,430	
Sales		380,400
Salaries and wages	61,400	

Creditors		14,100
Cash at bank	4,100	
Cash in hand	240	
Drawings	29,440	
Capital		18,827
	247,067	247,067

Stock at 30 April 2017 was K11,290.

2. The following is the trial balance of T Owen as at 31 March 2019. Draw up a set of financial statements for the year ended 31 March 2019.

	Dr	Cr
	K	K
Stock 1 April 2018	52,800	
Sales		276,400
Purchases	41,300	
Carriage inwards	1,350	
Carriage outwards	5,840	
Returns outwards		2,408
Wages and salaries	63,400	
Business rates	3,800	
Communication expenses	714	
Commissions paid	1,930	
Insurance	1,830	
Sundry expenses	208	
Buildings	25,000	
Debtors	45,900	
Creditors		24,870
Fixtures	1,106	
Cash at bank	31,420	
Cash in hand	276	
Drawings	37,320	
Capital		210,516
	514,194	514,194

Stock at 31 March 20X9 was K58, 440

3. F Brown drew up the following trial balance as at 30 September 2008. You are to draft the trading and profit and loss account for the year ended 30 September 2008 and a balance sheet as at that date.

	Dr	Cr
	K	K
Capital		49,675
Drawings	28,600	
Cash at bank	4,420	
Cash in hand	112	

Debtors	38,100	
Creditors		26,300
Stock 30 September 2007	72,410	
Van 5,650		
Office equipment	7,470	
Sales		391,400
Purchases	254,810	
Returns inwards	2,110	
Carriage inwards	760	
Returns	1,240	
Carriage outwards	2,850	
Motor expenses	1,490	
Rent	8,200	
Telephone charges	680	
Wages and salaries	39,600	
Insurance	745	
Office expenses	392	
Sundry expenses	216	
	468,615	468,615

Stock at 30 September 20X8 was K89,404.

CASH FLOW STATEMENT

What is cash flow statement?

It is a financial statement which shows us exactly where the cash has come from (source of funds) and exactly what we have done with it (application of funds) during a given period. It recognizes cash in hand and at bank plus cash equivalent.

Cash inflows are the sums of money received by a business during a period

Cash outflows are the sums of money paid out by a business during a period.

Explain two major parts of the cash flow statement

Sources of funds/cash inflows	**The application of cash funds/cash outflows**
Sources of funds may be from • Profits • Sale of fixed assets • Sale of goods by cash • Decrease in stock • Decrease in debtors • Capital introduced • Loan received/borrowing money from external source • **Increase in creditors** • **Selling shares**	The application of cash funds may be as follows • Losses • Purchasing fixed assets • Increase in stock • Increase in debtors • Drawings and dividends • **Decrease in creditor/paying creditors**

WAYS OF CAUSING FINANCIAL PROBLEMS TO A BUSINESS

1. Allowing customers too long credit period.
2. Purchasing too many fixed assets once
3. Overtrading- producing or purchasing too high level of stocks, expanding too quickly.

EXAMPLE 1

Td Ltd would like to obtain funding from one of the banks in Malawi. The financier has requested TD ltd to produce a cash flow statement for the past six months. The financial accountant extracts the following details.

Sources of funds (2014)

	K
March sales	140,000
April sales	260,000
May sales	290,000
June sales	400,000
June cash on disposal	205, 500

Application of cash funds

Monthly salaries January to June for K200, 000 for each month.
Equipment bought in January K90, 000

Required

Prepare the cash flow statement for TD ltd.

Cash sources	JAN	FEB	MARCH	APPRIL	MAY	JUNE
Cash sources Sales	-	-	140,000	200,000	290,000	400,000
Profit on disposal	-	-	-	-	-	205,000
Total Revenue	-	-	140,000	260,000	290,000	605,000
Cash application						
Salaries	200,000	200,000	200,000	200,000	200,000	200,000
Equipment	90,000	-	-	-	-	-
Total payment	290,000	200,000	200,000	200,000	200,000	200,000
Monthly net cash	290,000	200,000	60,000	60,000	90,000	405,000
Balance	290,000	490,000	550,000	490,000	440,000	5,000

INTERPRETATION OF THE CASH FLOW

In January and February, there are no revenue generated yet, the costs incurred sum up to K490, 000 for two months. Therefore, business from January to May incurs cash deficits. The business will get into a balanced situation in June when the deficit cumulative balance is wiped out and a surplus of K5, 000 is realized. Therefore, this business is not viable in the short run but in the long run.

Example 2

Construct a three month cash flow forecast from April for Matimba Investment Ltd from the following forecasted data.

Sales

	March	April	May	June
Sales	K150,000	K140,000	K160,000	K140,000

- Opening cash balance in April is K100,000
- All sales are 50% for cash and a 50% on one month credit.
- Purchases are made in the month of sale and were all for cash. The value of the purchases were 50% of the sales value.

	April	May	June
Expenses	K60,000	80,000	K120,000

Workings

	April	May	June
Opening balance	100,000	215,000	205,00
Receipts			
Cash (50%)	70.000	80,000	70,000
Credit (50%)	75,000	70,000	80,000
Total Receipts	**245,000**	**150,000**	150,000
Expenditures			
Purchases	70,000	80,000	70,000
Expenses	60,000	80,000	120,000
Total expenditures	**130,000**	**160,000**	**190,000**
Net cash flow	115,000	(10,000)	(40,000)
Closing balance	K215,00	205,000	165,000

Interpretation

In Matimba Investment Ltd, a positive net cash flow will increase the closing bank balance. Negative cash flow as in May and June will reduce the bank balance. Each closing balance becomes the opening balance for the next month. The bank account is overdrawn in the months of May and June.

WAYS OF SOLVING CASH FLOW PROBLEMS

4. Borrowing money from the bank over the time when you have a negative cash flow.
5. Reducing or delaying some of your planned expenses.
6. Increasing your forecasted income by engaging in a part time job.
7. Delaying paying some of your expenses until cash is available.