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ACCOUNTING GUIDELINES
FOR MICROFINANCE INSTITUTIONS
IN
UGANDA

Version 1

By Chris Malwadde

For

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ABBREVIATIONS AND ACRONYMS

CMF	Center for Microenterprise Finance, Kampala, Uganda
CPA(K or U)	Certified Public Accountant (Kenya or Uganda)
I&E Acct	Income and Expenditure Account
IAS	International Accounting Standard
MFIs	Microfinance Institutions
NGO	Non-Government Organization
NSSF	National Social Security Fund
PAYE	Pay As You Earn
PRESTO	Private Enterprise Support, Training and Organizational Development Project
P&L Acct	Profit and Loss Account
URA	Uganda Revenue Authority
USAID	United States Agency for International Development

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CHAPTER 1. BACKGROUND

1 1 INTRODUCTION

One of the main objectives of the Center for Microenterprise Finance (CMF) component of the PRESTO Project is to strengthen the institutions that provide savings and credit services to microenterprises within Uganda In keeping with this objective, the CMF developed these accounting guidelines specifically for Ugandan MFIs

In addition, the CMF requires MFIs participating in its grants program to have strong internal controls A review of the literature in the CMF library on MFI accounting revealed very little guidance on internal controls These guidelines seek to address this deficiency

In June 1997, the CMF completed a Baseline Survey and a Training Needs Assessment for 68 MFIs in Uganda An analysis of the data shows that fewer than ten per cent of these MFIs have accounting systems that can produce financial statements in accordance with generally accepted accounting standards The data also shows that about 45 per cent of the MFIs have some accounting system in place but with critical features of a good system missing Another 45 per cent have no system of substance These accounting guidelines have been developed to assist these MFIs to develop and/or improve their accounting systems It is the hope of the CMF that these guidelines will contribute to building capacity of MFIs in Uganda

The CMF has been mindful of the fact that different MFIs operate in different circumstances, face different challenges, and have a unique mix of program emphases, funding sources, methodologies and administrative systems The guidelines need to be tailored by each MFI to its own particular accounting requirements and operating environment These guidelines should help MFIs to produce accounts in accordance with generally accepted accounting standards that meet International Accounting Standards and to have acceptable internal controls If the credit program is one of several programs within an MFI, we suggest that the MFI create an independent (self-accounting) credit program, and then apply these guidelines

1 2· THE APPROACH

General information pertaining to the accounting and financial management function of an MFI, including the concept of internal controls, is covered first Thereafter five areas are covered from an accounting perspective

- Receipts
- Banking
- Payments

- End of accounting period journal adjustments
- Preparation and presentation of financial statements

For each area, accounting procedures and relevant internal controls are discussed Other relevant information, including a glossary of common accounting terminology is located in Chapter 5 Appendices at the end of the manual Recommended further reading is listed in 5 6 Recommended Further Reading

A separate section on budgeting is not included because these principles are outlined in Microstart (UNDP) and Finance Study Guide (Calmeadow) Suffice it to say that a budget is never created in its own right, but is the costing of an operational plan Planning a year ahead is fundamental, and a budget lists figures on costs and activities to be undertaken Sometimes organizations create a budget first and plan afterwards, but this is not an effective and efficient business practice

1.3: THE OBJECTIVES OF THE GUIDELINES

Through this manual, the CMF seeks to assist MFIs to develop adequate accounting systems so that

- Financial reports are accurate, current and complete
- Records will accurately identify the source and application of funds
- There is effective control over and accountability for all funds, property and other assets
- There is a budgetary control system in place

Accounting systems based on these guidelines can contribute to the level of confidence within an MFI If an MFI has an effective accounting system in place, stakeholders (e g , management, board, clients, donors, etc) will be able to assess whether or not an MFI

- Is in a position to meet its goals and objectives
- Can adequately safeguard and efficiently utilize resources
- Can obtain, maintain and fairly disclose reliable data
- Complies with applicable laws and regulations

1 4: HOW TO USE THESE GUIDELINES

These guidelines are prepared for MFIs of different backgrounds and therefore should be used only as a frame of reference as an MFI develops its own accounting system

The guidelines assume manual books of accounts Of course, MFIs that have computerized their accounting system would not use manual books of accounts Still, the accounting principles and the internal controls discussed in this manual remain applicable

For those MFIs that have some system in place, but with critical features of a good system missing, and for those with no system at all, management needs to consider the following strategy

- Employ a person with training in accounting For example, look for a Uganda Diploma in Business Studies and at least 3 years of working experience, or a CPA(U or K) Part One with similar years of experience If the MFI cannot afford a full time employee, it should consider hiring a part time accountant

- Have that person study these guidelines and compare the essential elements with the existing system Ask him/her to note the weaknesses in the present system

- Check how particular areas of weakness in the MFIs' system have been addressed in these guidelines

- Fine-tune the guidelines to suit the local environment of the MFI

- Adopt and implement

- Monitor and improve

- In case of difficulty in understanding any of the procedures in the manual, contact the PRESTO Center for Microenterprise Finance

CHAPTER 2: GENERAL ACCOUNTING PROCEDURES & INTERNAL CONTROLS

2 1. THE ROLE OF ACCOUNTING

The purpose of accounting is to provide financial information about an organization The financial information provided by an accounting system is needed by management and outside users to help plan and control the activities of an organization Accounting falls into two general categories *Financial accounting* and *Management accounting*

Financial accounting presents a summary view of the financial results of past operations and is especially geared for external audiences (although this information is used internally as well)

Management accounting tracks and presents financial information at a much more detailed level Budgeting and costing are part of management accounting Management reports are prepared frequently, and highlight the differences between planned and actual financial results

The ultimate aim of accounting is the production, analysis and interpretation of financial information The figures that are produced in financial statements are therefore significant, as there must be a meaningful relationship between these figures and actual activities

2.2. CHART OF ACCOUNTS

An MFI must create a systematic record of daily business activity in order to provide up-to-date financial information There must be a separate record for each item that appears in the financial statements For example, a record should be kept for *cash* showing all the increases and decreases in cash which result from all transactions in which cash is received or paid The same would apply to *staff salaries* a record should be kept of all salary payments in a given period This type of record, which is used to record increases and decreases in a single item in the financial records of an organization, is called an *account*, or sometimes a *ledger account* (A sample of a ledger account is illustrated in 4 1 Ledger Account) A list of *accounts* would form what is known as a *Chart of Accounts*

The number of accounts needed by an MFI will depend on its size the nature of its operations or activities the type of products it is offering the reporting needs, and the extent to which management and stakeholders want detailed classification of information The MFI should develop a Chart of Accounts to suit its purposes A sample of a Chart of Accounts that would suit a typical MFI is found in 5 1 Chart of Accounts

While each MFI has unique characteristics which should be reflected in its Chart of Accounts, all Charts of Account can be divided into five basic categories revenue expenses, assets, liabilities, and capital

Revenue The revenue account will be determined by the actual and potential sources of revenue or income Each source of income will have an account within this category See the examples given in the sample Chart of Accounts

Expenses The expense account is where the greatest number of account titles are found Because the list is potentially long, the MFI may consider classifying expenses by function rather than by item For example, instead of having expenses listed as office tea, office supplies, and office cleaning supplies, it may be better to have one account that would combine these as *General Office Expenses* Having numerous expense accounts burdens a record keeping system, particularly if the sum total of these expenses is not significantly large

Assets Within this category are three main types of accounts *Current Fixed* and *Other*

- **Current Assets** Main categories would be the loan portfolio, cash in its different forms, and short term investments (deposits)

- **Fixed Assets** Physical items of value, such as vehicles and computers

- **Other Assets** Assets that would not readily fit either of the categories above are entered here These might include restructured loans, and long term investments that will not be realized in cash in less than one year

Liabilities These include items that the MFI owes There are essentially two main accounts in this category *Current* liabilities and *Long-term* liabilities

- **Current Liabilities** These are obligations that the MFI expects to pay off within one year Examples include clients' savings and interest payable on these savings

- **Long-term Liabilities** These are obligations that the MFI expects to retire or clear in more than one year's time Examples include long-term loans from commercial and concessionary sources

Capital This is the value or net worth of the MFI It is referred to as the net worth because its reported value is equal to the difference between total assets and total liabilities Unlike liabilities, the capital of an organization does not have to be repaid, as it represents what the MFI owns Capital may be sub-divided as follows

- **Loan Fund Capital** This represents contributions over time to the MFI for the loan fund, less losses incurred through irrecoverable loans Loan fund capital may include grants designated by donors for the loan fund

- **Capital Grant (Fixed Assets)** This represents grants given to the MFI specifically for the purchase of fixed assets The balance on this account would represent the portion of the grant that has not yet been transferred to the Profit and Loss Statement This type of capital (or equity) like Loan Fund Capital cannot be distributed

- **Owners' Capital (for a Company Limited by Shares)** This represents the owners' contributions to the running of MFIs that are profit-making companies

- **Originators' Capital Loan (for an NGO/Company Limited by Guarantee)** This is the amount of capital put into an NGO/MFI to enable it to start operations

- **Retained Net Surplus/Deficit -- Prior Years** This is the amount of income (or deficit) accumulated since the formation of Companies Limited by Guarantee This part of capital is retained by the MFI for capitalization purposes

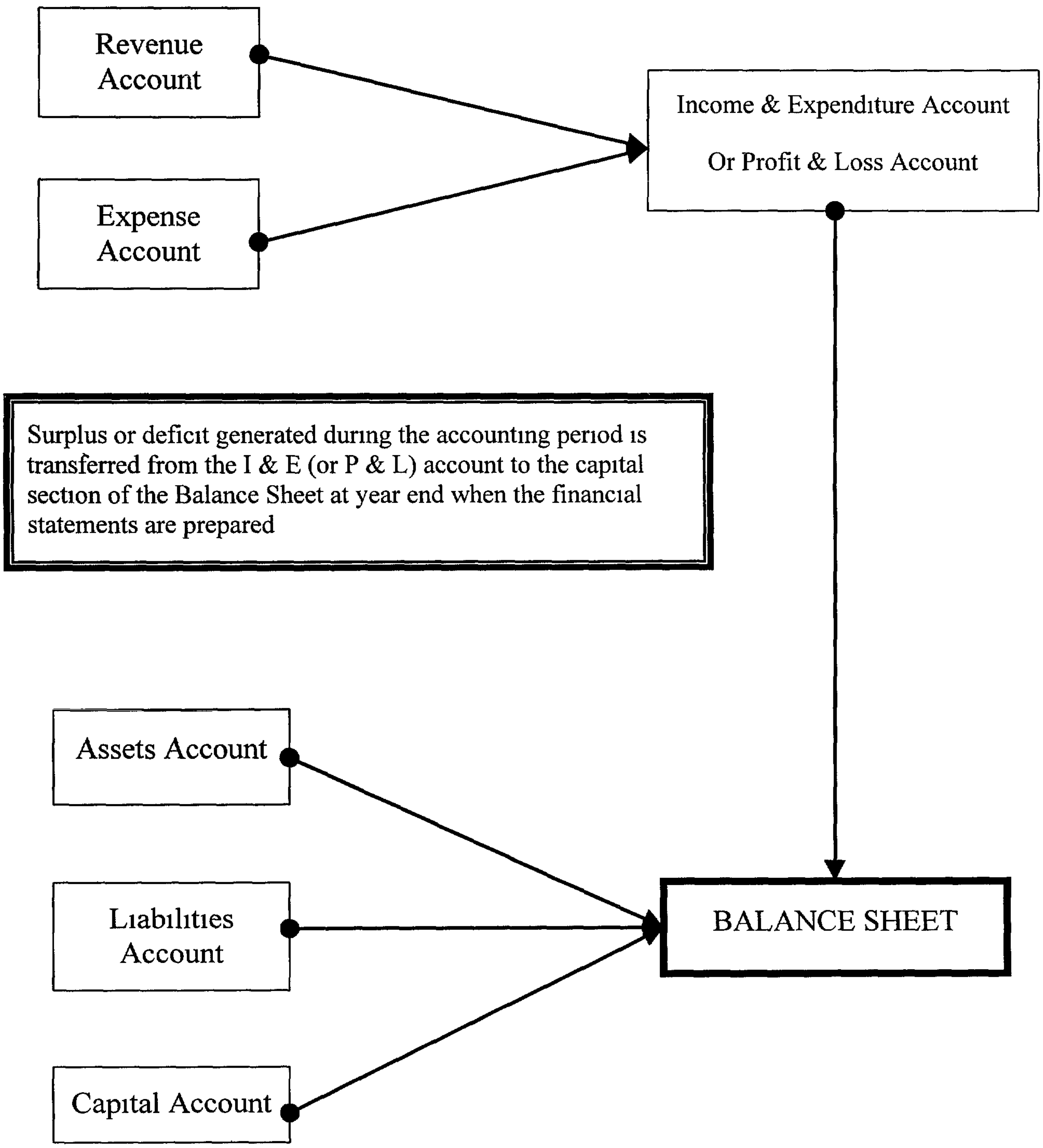
- **Retained Profit/Loss – Prior Years** This is the amount of income (or loss) accumulated since the formation of a Company Limited by Shares It may be retained for capitalization purposes or distributed

- **Net Surplus /Deficit or Net Profit/Loss -- Current Year** This is the amount of income (or loss) generated in the current year's operations

For identification and reporting purposes, each source of funds *must* be given its own account within the generic account 'Capital' For example, *Owners Capital* must not be co-mingled with *Grants* in one account They must be reported separately in the Balance Sheet

Flow Chart 1 illustrates how different accounts flow into a financial statement Please note that a profit-making organization or Company Limited by Shares makes profits and/or losses and thus has a Profit and Loss Account (P & L) In contrast, an NGO or a Company Limited by Guarantee makes surpluses and/or deficits and has an Income and Expenditure Account (I & E)

Flow Chart 1 How Accounts from Chart of Accounts Relate to Financial Statements



2 3 BASIC BOOKS OF ACCOUNT & OTHER RECORDS

Now that a Chart of Accounts has been created and all financial information has been classified, the accountant must identify and collect the documents, books and other records that are required to generate the necessary information pertaining to the MFIs' financial transactions These include all relevant *source documents* and all books of prime entry, called *journals* Journals include the cash book, general journal, and subsidiary journals such as the loan disbursement journal, loan repayment journal, payroll journal and petty cash book The monthly totals of the transactions recorded in these journals will be posted to the general ledger

Source Documents These are documents which have resulted in cash disbursements or receipts and are evidence of money spent or received They include the original evidence of transactions such as invoices, payment advices, demand notes, payment requisitions, fee notes, cheques, receipts, etc These assorted business documents are the starting point for the flow of accounting information through the accounting system and into the financial statements They form the basis for entries into the journals

Cash Book The cash book is where all bank transactions of the organization are recorded Whenever money leaves the organization, the bookkeeper records the transaction in the cash book as a payment Similarly whenever cash is received by the organization, the accountant records it in the cash book as money received In both instances, the nature of the payment and the source of the receipt are clearly identified A sample *receipts* side of the cash book is shown in 4 3 Cash Book – The Receipts Side, and a sample *payments* side is shown in 4 6 Cash Book – The Payments Side

Petty Cash Book The petty cash book is used to record small office expenses paid out in cash An imprest (that is, a petty cash float of a reasonable amount) should be created to meet such expenses and would be reimbursed from the bank about twice a month or whenever the amount of petty cash is running low

General Journal The general journal records all transactions that are not recorded in either the cash book or petty cash book because there was no immediate involvement of cash For example, a received and unpaid telephone bill represents an accrual of expenses that must be recorded Other entries in the general journal include a provision for depreciation, loan loss reserve and adjustments for prepayments Any corrections of accounting entries, ordinarily end-of-accounting-period journal adjustments, would be found here

Subsidiary Journals Subsidiary journals may be created if there are enough transactions in a single general journal category to warrant it For example, a *Purchases Journal* is used by some organizations Entries would be made on a monthly basis and summaries posted monthly See the description below of *Loan Tracking Records* for another example of a subsidiary journal

Payroll Journal A separate payroll journal, a subsidiary of the general journal, is necessary if an MFI has a large number of employees This journal handles all payroll transactions It is necessary to separate such payments from either the cash or petty cash books for reasons given in the accounting procedures for payroll later in the guidelines See section 3 3 Payments

Ledger The ledger is a book of secondary entry It is where all the entries in the cash book, petty cash book, and journals will be posted and accumulated in various accounts as defined in the Chart of Accounts The end product will be a running or cumulative balance for each account in the ledger The general ledger consists of a sheet or card or page in the ledger book for each account listed in the Chart of Accounts See section 4 1 for an example of a ledger account and section 4 2 for an illustration of how debits and credits affect an account in the general ledger

Loan Tracking Records Loan tracking records are a helpful way for an MFI to maintain accurate information on borrower accounts These records consist of both subsidiary journals *and* a subsidiary ledger The journals are the loan disbursement and loan repayment journals The ledger has an account for each borrower with relevant details (name, loan amount disbursed, and the amount repaid) From these accounts, management will be able to tell the amount due from a client

Trial Balance Before using the account balances to prepare financial statements, the accountant must prove that the total of all accounts with debit balances are equal to the total of all accounts with credit balances This is achieved by a *trial balance* A simple trial balance is a two column schedule listing the names and balances of all the accounts in the order in which they appear in the ledger The debit balances are always listed in the left-hand column and the credit balances in the right-hand column The total of the two columns should agree If they do not agree, the accountant should not prepare financial statements until the errors are found and corrected

2 4 PREPARATION OF FINANCIAL STATEMENTS

This is the last step in the accounting cycle All financial information emanating from the ledger and proved correct by the trial balance will be summarized in the financial statements Financial statements are the primary means through which an MFI communicates information about its activities Every accountant's priority is to ensure that this information is prepared on time, is accurate, and conforms to the reporting needs of the various users Reporting needs determine whether a Management Accounting Report is produced for internal use by management, or a Financial Accounting Report is produced for other stakeholders

To produce accurate reports according to the needs of the organization, the accountant must have a solid knowledge of *fundamental accounting concepts*, *accounting bases*, *accounting policies*, *disclosure requirements*, and *reporting needs* for different users of financial statements

Fundamental Accounting Concepts Fundamental accounting concepts are the broad basic assumptions that are used to prepare the periodic financial accounts of business enterprises The *International Accounting Standard 1* singles out three as most important *The Going Concern*, *Consistency*, and *Accrual* concepts

- **The Going Concern** This concept states that users of a financial statement may assume that the enterprise in question will continue in operational existence for the foreseeable future This means that the P&L Account or I&E Account and the Balance Sheet assume no intention or necessity to liquidate or curtail significantly the scale of operation In other words, all users of a financial statement generated by an MFI should be able to safely assume that the MFI is an on-going business

- **Consistency** There must be consistency in the accounting treatment of like items within each accounting period and from one period to the next This means that an MFI should be consistent in the accounting policies that it follows For example, there are several ways of calculating depreciation The main ones are the straight-line method and the reducing balance method An MFI may choose whichever way of calculating depreciation that makes sense within the environment of the organization But, the MFI must be consistent over time with whatever method and rates it chooses

- **Accrual** Revenues (income) and costs (expenditure) are accrued, or recognized, as they are earned or incurred (not only as money is received or paid) They are then recorded in the books and financial statements for the relevent periods Revenue dealt with in the P&L/I&E Accounts must be matched with associated expenses by including, in the same financial statement, those expenses incurred in earning that revenue

Note If an MFI is inconsistent by changing accounting policies often, it is in danger of manipulating reported results and places its credibility at risk This does not mean, however, that once an MFI adopts an accounting policy it must keep to that policy forever The overriding principle is that the financial statements should present a 'true and fair view' and if the MFI believes that changing from one accounting policy to another will lead to this, then the change is acceptable However, any change of policy and the impact of it must be reported in the notes to the financial statements

Accounting Bases Accounting bases are methods developed for applying the fundamental accounting concepts to financial transactions Different accounting bases will have a material effect both on reported results and on the financial position of an MFI, so the choice of accounting bases is important Choice of accounting bases will affect matters such as the depreciation of fixed assets, the conversion of foreign currencies and the accounting treatment of grants

For example, there are several bases (or methods) used to depreciate a fixed asset One is the straight-line method (whereby the cost of an asset is written off equally over the lifetime of the asset), and another is the reducing balance method (whereby a fixed percentage of the net value brought forward from the previous year is written off annually) The choice of one over the other will significantly affect the financial statement and the choice should be made carefully But, whatever basis is chosen must remain consistent throughout the depreciation 'life' of that particular asset

Accounting Policies Accounting policies are the specific accounting bases selected and consistently followed by an MFI They must be appropriate to the particular circumstances of an MFI and best suited to present fairly its results and financial position As mentioned above there are several methods (or bases) available in order to depreciate an asset The method chosen by the management of the MFI becomes the accounting policy of that MFI

Disclosure In the absence of a clear statement to the contrary, users of a financial statement presume that all fundamental accounting concepts have been observed by the reporting agency or organization The IAS-1 requires that notes to the financial statement fully disclose all accounting policies followed by an MFI

Accounting Period For purposes of making accounting measurements and preparing financial statements, the life of a business is divided into accounting periods of equal length The accounting period refers to the span of time covered by the P&L or I&E Account The usual accounting period is one year, called the *accounting year* or *fiscal year* An MFI may want to adopt the calendar year or the government financial year (July to June) as its accounting year In some cases, a stakeholder may suggest which accounting year an MFI should use

Users of Financial Statements For the average MFI, we have identified three users *management*, *owners*, and *other stakeholders*

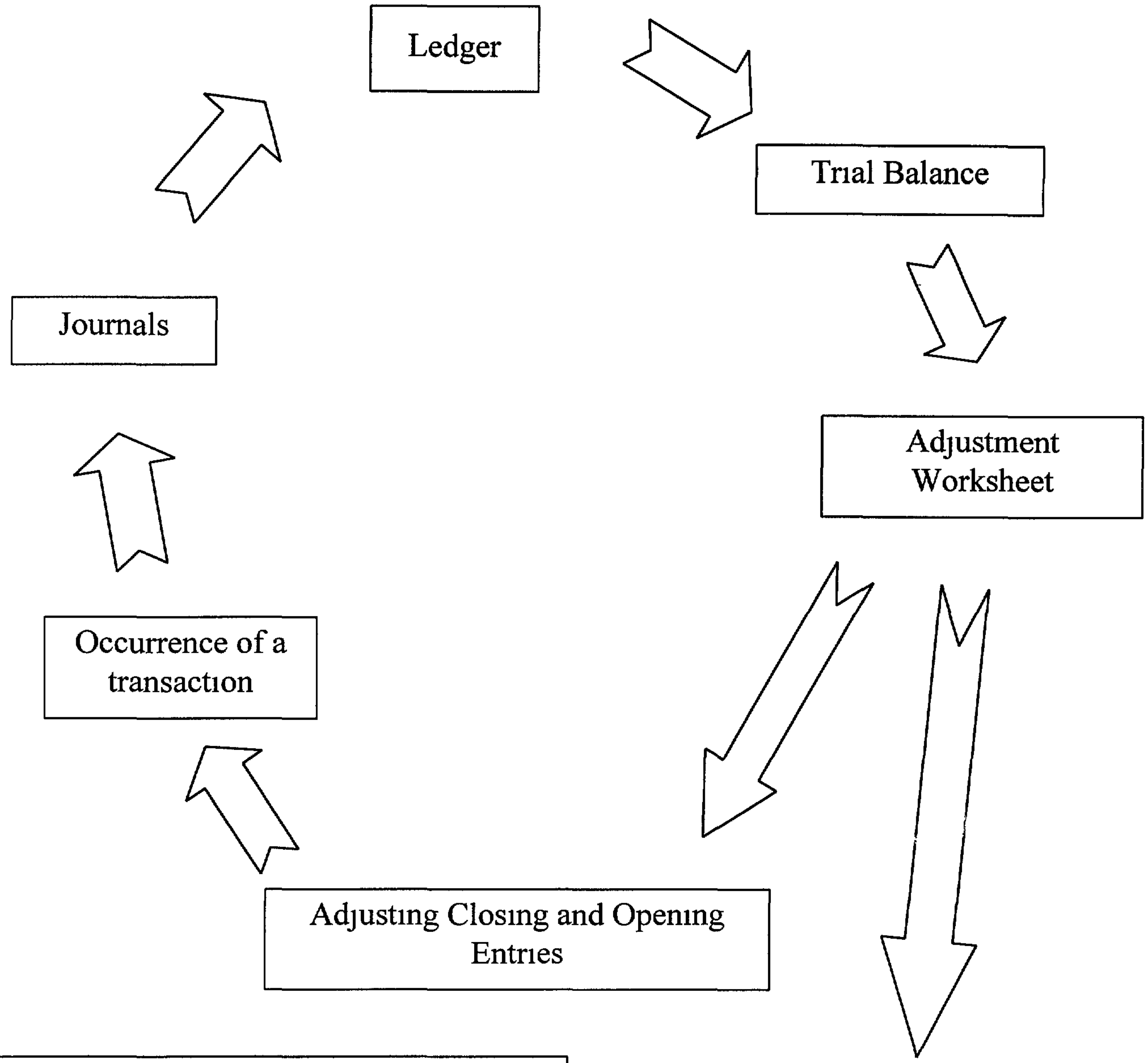
- **Management** The management of an MFI is comprised of insiders who will have the financial statements prepared for their own use and decision-making Accounting information is tracked and presented at a highly detailed level, such as by program or branch or geographical area Analysis of variance of budgeted financial information is an integral part of management accounting information Management reports are prepared frequently and provide on an on-going basis the differences between planned and actual results As these reports are targeted for insiders, they have only to be prepared and presented in a form required by management

- **Owners** These include shareholders and founders This group should require only the balance sheet and the profit and loss account, which would normally be presented in the annual general meeting

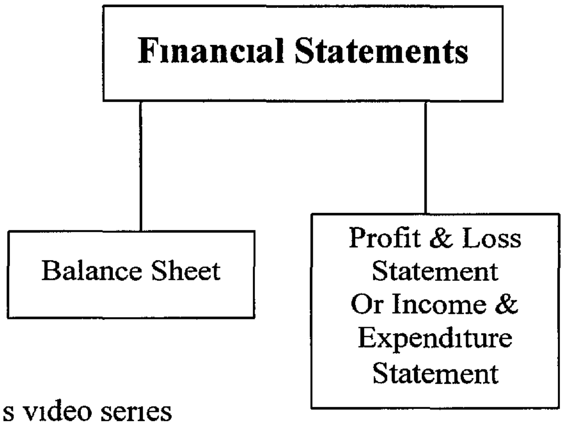
- **Other Stakeholders** These include government agencies such as the central bank, prospective investors and clients Because this group is so diverse, the financıal statements are prepared ın accordance wıth IAS The financıal statements recognızed by IAS ınclude a balance sheet, a profit and loss account (or ıncome and expendıture statement), notes, and other statements and explanatory materıal whıch are ıdentıfied as beıng part of financıal statements Thıs group may also ınclude stakeholders who hold a partıcular ınterest ın the MFI and have specıfic reportıng needs An MFI that ıs dependent on a partıcular stakeholder wıll need to follow requıred guıdelınes or develop systems and reports that are acceptable to thıs stakeholder

Flow Charts 2, 3 and 4 present alternatıve vıews of the sequence of steps through whıch ınformatıon flows ın an accountıng system, from a busıness transactıon to the users of a financıal statement

Flow Chart 2 The Bookkeeping Cycle

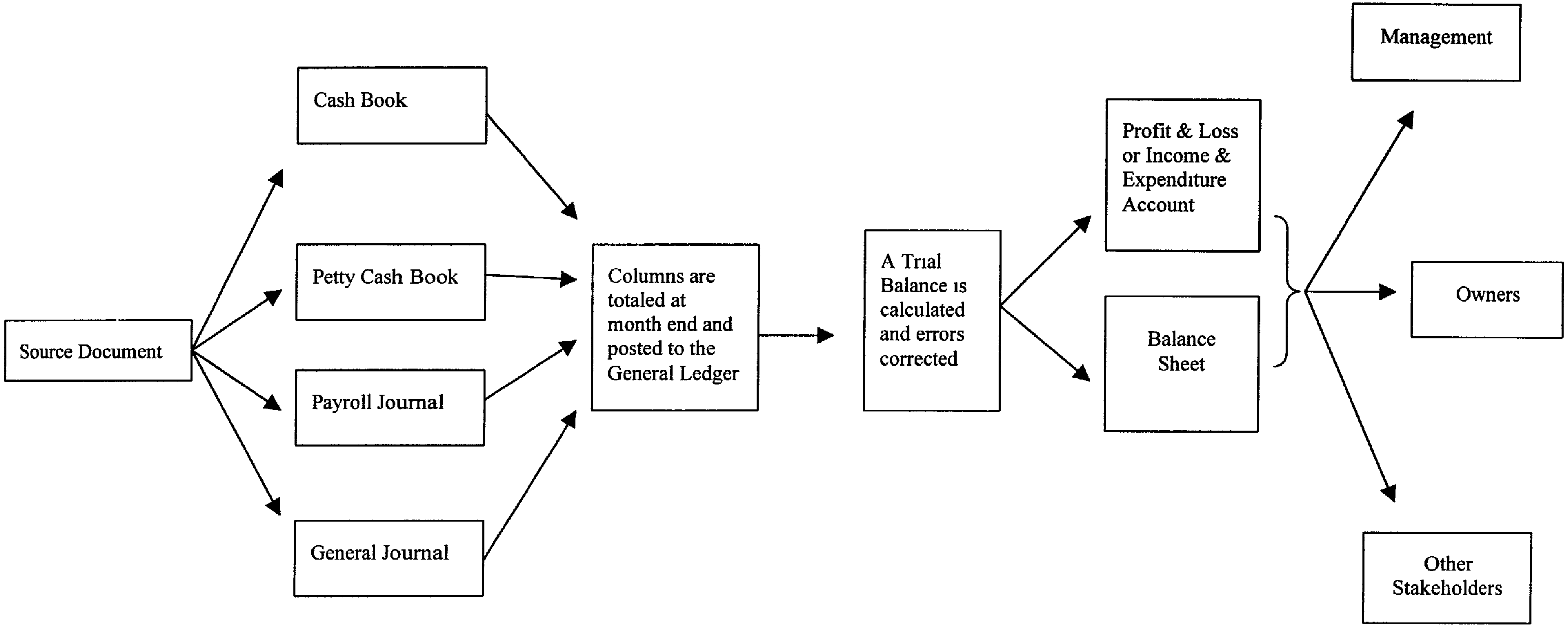


Information from source documents is posted into journals according to the appropriate accounts and their debit/credit classification Information from journals is posted into the General Ledger Information from the General Ledger is summarized through a Trial Balance An Adjustment Worksheet is used to rectify mistakes Adjusted information flows to P&L (or I&E) and the Balance Sheet and is used to adjust opening and closing entries



Source This diagram has been adapted from Fred Moore's video series *Finance for Non-Financial Professionals*, Careertrack Publications, Boulder, CO, USA

Flow Chart 3 Flow of Financial Information from Source Document to the User



Flow Chart 4 Sequence of Steps from Source Document to User of Financial Statements

Business Transaction

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Preparation of Source Document

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Information entered into books of original entry cash book, petty cash book, general journal, payroll journal, subsidiary journals

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Debits and Credits posted to General Ledger

↓

Trial Balance Prepared from Ledger

↓

Financial Statements Prepared from Trial Balance

↓

Users of Financial Statements

2 5 GENERAL INTERNAL CONTROLS

Management needs assurance that the accounting data flowing to and from the accounting department is accurate, complete and dependable, that its assets are safe, that there is general efficiency in the organization and that there is compliance with MFI policies Developing a strong system of internal control provides this assurance The system of internal controls includes all measures taken by an organization for the purpose of protecting its resources against waste, fraud and inefficiency Internal controls should also ensure accuracy and reliability in accounting and operating data, as well as compliance with MFI policies and procedures Finally, internal controls help management to evaluate the performance levels in all divisions of the MFI

The Board of an MFI must recognize that it is ultimately responsible for the entire internal control system of the organization and for guaranteeing the smooth running of the MFI To this end, the Board must ensure proper registration of the MFI in accordance with the laws of Uganda

After satisfying all the legal requirements, an MFI must do the following to ensure a strong internal control system

Specify the Mission Statement MFI management should document background information on the nature and purpose of the organization and inform all staff members A clear sense of purpose is basic to effective work as an MFI

Specify the Organizational Structure An MFI's operations should be divided into appropriate divisions and departments, and management staff appointed to assume responsibility for each Clear lines of responsibility between each division and department and the Board of Directors must then be established Finally, senior management must guarantee that there is overall co-ordination of the MFI's activities so as to meet its mission

Control Transactions Every transaction must go through four steps authorizing, approving, executing and recording An example is the delivery of credit to an individual within a group Based on specific criteria, a loan application by an individual is authorized by the group Then, a loan officer and a Loan Committee made up of senior management approve the loan Next, the Head of the Credit Department approves the disbursement of the loan from an authorized list Then, the accountant executes the transaction by preparing the necessary documentation and releasing money to the borrower Finally, the accounts department records the transaction in the account books

Separate or Subdivide Duties Management should separate duties in such a way that no single person or department handles a transaction from beginning to end When duties are divided in this manner, the work of one employee serves to verify that of another and any errors that occur should be detected promptly To strengthen this measure, management should consider rotating employees, e g credit officers might be periodically interchanged between geographical areas

Number Documents Serially Put serial numbers on source documents where applicable e g receipts, petty cash vouchers, etc The use of serial numbers makes it possible to account for all documents

Recruit Competent Staff Recruit staff with required training, skills, experience, and unquestionable integrity Even the best-designed systems of internal control will not work unless the staff assigned to operate it is competent and honest

Establish a Budgeting and Budgetary Control System Specify goals for the organization and activities needed to achieve those goals for a given period, and then assign a budgetary cost Actual monthly results are compared to the budgeted figures, and management's attention is then promptly directed to any problem area Any system of internal control is strengthened by the use of budgets because errors can be identified promptly and fully investigated

Institute Proof Measures Establish monthly procedures such as preparing a trial balance, preparing bank reconciliation statements, reconciling control accounts and underlying subsidiary ledgers, and comparing daily receipt summaries with the following day's banking In this way error and/or fraud is quickly detected

Acknowledge Performance All staff who perform data processing operations, especially from accounts and credit departments, must acknowledge their activities and involvement by means of their signatures or initials Require that those outside the MFI sign the cheque register when they receive a cheque by hand

Install Protective Devices Invest in safes, burglar proofing on the cashier's office and a security system or guards for the premises

Establish an Internal Audit Department This is particularly feasible in large MFIs Internal auditors are staff members (as opposed to external auditors) and their main priority is to ensure compliance with internal controls They also continually review the controls and evaluate their relevance in an ever-changing business environment

Hire External Auditors to do Annual Audits Although strictly speaking not part of internal controls, an audit instills confidence in the financial statements of the MFI External auditors normally prepare a management letter or a letter of weakness that highlights weaknesses in the control and accounting systems The MFI should use this letter to strengthen its system

Document the Accounting System and Internal Controls The entire accounting system and relevant flow of procedures must be documented as management policy All staff should be aware of policies and put them into practice

Have Regular Staff Meetings The agenda should include a briefing about any new policies, controls, or revisions

Establish a Filing System All source documents, copies of management reports and financial statements must be filed to ensure that information is secure and that there can be quick retrieval when required

CHAPTER 3: ACCOUNTING PROCEDURES & INTERNAL CONTROLS IN SPECIFIC AREAS

A typical MFI's business normally revolves around several areas It receives funds for its loan portfolio, which are deposited in the bank It gives credit to its clients using a specific methodology (which should be explained in a 'Credit Policies and Procedures Manual') It receives repayments of loan capital, interest payments and administration charges, and then deposits these in the bank It invests any unused funds that have not been loaned and earns interest on them It makes a variety of payments to meet its expenses It procures large items such as buildings, motor vehicles and computers according to budget and subject to availability of funds And it prepares periodic financial reports, which are presented to interested parties

For the purposes of these guidelines, the above financial activities can conveniently be categorized into five areas as follows

- Receipts (3 1)
- Banking (3 2)
- Payments (3 3)
- End of accounting period journal adjustments (3 4)
- Financial statement preparation (3 5)

3.1. RECEIPTS

Receipts represent the money an MFI receives in any form A typical MFI would receive money from some or all of the following sources

- Grants for the loan portfolio
- Grants for the purchase of fixed assets
- Grants for the financing of certain expenses
- Commercial loans from banks and other institutions
- Concessionary loans mainly from donor agencies
- Clients' savings
- Investment income from funds invested by the MFI
- Contributions from the owners of the MFI

- Interest on loans to clients
- Fees and service charges on loans to clients
- Loan repayments
- Money received from clients whose accounts previously had been written off
- Money received from sale of clients' collateral (in case of loan default)
- Money received from the sale of MFI's assets in case of disposal when they are no longer used in the MFI's operations

Solid accounting procedures and good internal controls will ensure that all monies coming into the MFI from all sources are properly documented, analyzed and summarized The specific accounting procedures for recording receipts are straightforward

- Ensure that each source is listed in the Chart of Accounts, in the revenue section
- If it is not, create a new account in the Chart of Accounts and in the general ledger
- Make an entry in the cash book on the basis of the source document Each receipt source should have a matching source document For example, a source document may consist of a remittance advice from a donor or a bank pay-in slip or cash receipt issued by the MFI for a loan payment
- Each time money is received, debit the *bank* column in the cash book and credit the *analysis* column for that particular source Enter the date and particulars of the transaction in the space provided
- Total the columns each month and post the totals to the appropriate accounts in the general ledger From the receipts side of the cash book, the totals in each column should be posted to the corresponding accounts in the general ledger

Three examples are provided as illustrations

Example One A generous grant has been received and Ush250,000,000/- has been transferred to the MFI's account Ush150,000,000/- is for the loan fund, Ush50,000,000/- is for the purchase of vehicles, and Ush50,000,000/- is for the payment of operating expenses for two years

	Debit	Credit
Grant for the Loan Fund		
Cash in bank (asset account)	150,000,000	
Loan fund grant (capital account)		150,000,000
Grant for the purchase of vehicles		
Cash in bank (asset account)	50,000,000	
Capital grant (capital account)		50,000,000
Grant for payment of operating expenses		
Cash in bank (asset account)	50,000,000	
Deferred revenue (liability account)		50,000,000

Note that capital grants for fixed assets should be allocated to income over the life of the assets Refer to Section 3 4, subsection on 'Adjustments to Capital and Deferred Revenue Grants for more information on this and on adjustments to deferred revenue

Example Two One of the directors brings a donation of Ush50,000,000 as a contribution to MFI operations An appropriate accounting entry must be made

	Debit	Credit
Cash in bank (asset account)	50,000,000	
Capital (originator's contribution account)		50,000,000

Example Three Various borrowers have made repayments on their loans Proper accounting entries must be made

	Debit	Credit
Cash in bank (asset account)	2,500,000	
Loan portfolio (asset account)		2,500,000

This entry is supported by a list in the loan repayment journal of all clients whose combined repayments total Ush2,500,000/-

	Debit	Credit
Client 1		300,000
Client 2		250,000
Client 3		150,000
Client 4		100,000
Client 5		200,000
Client 6		350,000
Client 7		150,000
Client 8		200,000
Client 9		150,000
Client 10		200,000
Client 11		450,000
Loan portfolio (asset account)		2,500,000
Cash in bank (asset account)	2,500,000	
	2,500,000	2,500,000

The purpose of the loan repayment journal is to provide details of entries in the cash book so that the status of each client or group can be tracked A similar entry is made in the subsidiary records when loan disbursements are made See the section on loan disbursements in Chapter 3 3 Payments

A ledger card or account is opened for each client or group (depending on the methodology used) in a subsidiary ledger Periodically, all the entries in the loan repayment journal are posted to their respective accounts in the subsidiary ledger

Internal Controls Internal controls in cash collection are essential The objectives of internal controls pertaining to receipts are to ensure that all funds (including physical cash and cheques) are actually received accounted for and entered in the records Additional controls must be established to ensure that all receipts are promptly deposited in the bank, and that all cash in transit is secure from theft

Whenever cash is collected or dispersed, there is a potential security risk An MFI must strive to protect all cash transactions A number of measures can be taken to maximize control and minimize problems Here are some suggestions to help management think through the issue of cash control

- Adopt a formal system of acknowledging all types of money that come into the organization Three examples are provided

  Example One - Grants from Donors It is common for donors to send funds directly to an MFI bank account It is important, therefore, that the

MFI sends correct information regarding its account to the donor Normally donors will specify the way in which their grants must be acknowledged The MFI must comply with this and keep a copy of the relevant documents in the donor agreement file In the unlikely event that the donor does not specify acknowledgement, the MFI should acknowledge by a formal letter (on MFI letterhead) to the donor, a copy of which must be kept in the agreement file The acknowledged amount must tally with the amount as per donor communication and also reconciled with the amount credited to the MFI account

Example Two - Loan Repayments from Clients Identify those persons who are authorized to receive cash, i e the cashier and the credit officers The MFI should consider having the clients pay directly to the MFI's bank account and ask the bank to keep a copy of the bank paying-in slip for the MFI's record

Example Three - Savings Deposits from Clients The MFI should consider asking clients to make their deposits directly to the MFI's account in the nearest bank branch and to keep bank deposit books as evidence

- Use cash receipts for every cash transaction, and establish a means of evidencing cash receipts, including cheques by using pre-numbered triplicate receipts The copies of the receipts form a basis for record keeping as demonstrated above The receipt books must be securely held and their issue controlled

- Ensure that unused receipt books are kept secure by a responsible MFI official who is not involved in receiving money Maintain a receipt book register and require that all individuals using receipt books account for previous receipt books before being issued another

- If clients must bring cash to the MFI's office for deposit or repayment, inform the clients that they must receive an official MFI receipt on payment Clients can be sensitized to the issue of cash control in meetings or training sessions

- Appoint officers who, at the end of each day independently check on cash received

- Ensure that there is adequate cash in the petty cash fund from which small payments may be made so that cash receipts are not used for this purpose

- Ensure that banking is done daily

- Ensure that there are physical control measures in place For example, the cashier should be located in a low traffic area, preferably in a private office or room A safe can be used to store cash received until it is taken to the bank Security guards may be employed This would minimize chances of money being stolen between the time the cash is received and when it is banked

- Where feasible, staff members can be rotated between different positions in the accounts department

- If the MFI's bank account is not a foreign account, and grants are credited on a shilling account, establish that the correct exchange rate has been used

- Divide cash handling and related accounting tasks Separate receiving of cash from recording of transactions The cashier who is the custodian of the incoming cash should not maintain the accounting records and should not have access to the records Likewise the accounting personnel should not have access to cash The recording function can also be subdivided among employees, so that the work of one person can be verified by another The one who deposits money in the bank should not be responsible for reconciling the bank and cash book balances The function of receiving cash must also be separated from that of disbursing cash, i e the person receiving cash should not also handle cash disbursements

- Put in place a system of surprise checks by some staff on others For example, senior staff should make unscheduled checks on receiving cashiers and those who make bank deposits If the staff that handles cash in any form knows that surprise checks are possible, and if these checks are truly carried out randomly, the risk of theft or 'borrowing' cash received or to be deposited will be reduced

- If the cash amount deposited daily is large, the MFI should consider buying an insurance policy to cover cash in transit The MFI may also consider, if the circumstances warrant, hiring an armored van or asking the bank to come and collect the money

3.2· BANKING

Careful accounting of bank transactions is important to maintaining accurate records The objective of good accounting procedures with regards to banking is to ensure that there is a proper accurate and timely record of the MFI's banking which agrees with the MFI's bank account record in the bank The record keeping procedures in this area have alreadv been taken care of in the cash book, which is maintained by the MFI See both the receipts and payments sides of the cash book

The MFI should maintain good accounting and internal controls in order to ensure that all funds (all money received) are deposited without delay at prescribed and appropriate intervals, preferably daily The MFI must be certain that money in the bank is safe from abuse, fraud or theft, and the accounting department must certify that the bank's records are in complete agreement with the MFI's cash book

This means that deposit slips must be prepared properly, and the cash book records kept meticulously The accounting department must obtain monthly bank statements and reconcile all accounts as soon as statements are received When stakeholders require their grants to be kept separately from other funds, the management of the MFI must ensure that there is a separate bank account for each of such grants It is the responsibility of the accounting department to keep accurate records of all bank accounts

There are a number of measures that an MFI can take in order to ensure good internal controls relevant to banking Many of these measures involve good accounting procedure We suggest that MFI management consider the following

- Open a bank account with responsible officials as signatories Such officials must be at least three in number, with at least two signatures required for any transaction The bank must be advised of the maximum authorized amounts over which the respective signatories are not supposed to sign cheques

- Advise donors of the account name, number and the bank's name and address

- A staff member who is not involved in receiving cash or in record keeping should prepare bank deposit slips

- There should be independent comparison of deposit slips with cash received records

- Banking should be done with security in mind, e g use security guards when depositing large cash sums

- Obtain bank statements at least monthly from the bank

- Designate a person who is not involved in the banking process to reconcile the bank accounts on a monthly basis See bank reconciliation procedure in section 5 2 Procedure for Preparing Bank Reconciliations

- A responsible official of the MFI who is not a signatory should keep the chequebook All cheques (including cancelled ones) must be accounted for in the MFI's records before a new chequebook is requisitioned

- Under no circumstances should a blank cheque be signed

3 3· PAYMENTS

For a typical MFI, payments fall into six areas

- Petty cash

- Loan disbursements

- Procurement of fixed assets

- Procurement of supplies

- Payroll
- Routine periodic bills such as telephone bills and interest on borrowed funds

In general, the accountant's objective should be that all payments are made from an approved budget for the period, that they are properly authorized and approved following established policies and procedures, and that they are they properly recorded, analyzed and summarized

Each of these areas warrants individual attention

Petty cash For accounting and internal control purposes, all transactions should be made by cheque whenever possible Unfortunately, this is not always possible and every business will find it convenient and necessary to have a small amount of cash on hand in order to make minor expenditures An imprest system or petty cash fund, the size of which will depend on needs and circumstances, can be created

To create this fund a cheque is written for an amount that will cover any small items of expenditure that must be purchased by cash for a certain period of time MFI management determines the amount of money and the time period The cheque is cashed, and the money is kept on hand in a safe place, such as a safe or a petty cash box in the office

An accounting entry must be made in the cash book for the creation of this fund The petty cash account is debited, and cash in bank is credited

The paying cashier fills out a petty cash voucher for each item of expenditure, filling in the amount, the purpose of the expenditure, the date, and the signature of the person receiving the money Supporting vouchers (where applicable) should also be attached

A petty cash voucher must be prepared for *every payment made* The petty cash box should, therefore, always contain cash and/or vouchers totaling the exact amount of the petty cash fund

Petty cash payments will be recorded and analyzed separately in the petty cash book and then incorporated within the cash book like any other payment when the fund is replenished

The accounting entry in the cash book for the replenishment of the petty cash fund is as follows

	Debit	Credit
Fuel for service vehicles	35,000	
Office expenses - sugar	5,000	
Public transport for staff	50,000	
Office supplies	37,000	
Casual labor	85,000	
Staff advances	120,000	
Petty cash fund		332,000
Totals	332,000	332,000

To replenish the petty cash fund as described above, a cheque should be prepared payable to 'Cash' for the exact amount of the expenditure in the preceding period This is so that the amount of petty cash remains constant throughout the fiscal or financial year Using the example above, a cheque in the amount USh332,000 would be drawn to replenish the cash up to the amount originally drawn

Management must ensure that the petty cash fund remains free from embezzlement and fraud A number of preventive measures for internal control can be considered

- Designate a responsible person as custodian or cashier for this fund
- Inform the petty cash custodian that occasional surprise counts of the cash will be made and that he/she is personally responsible for the fund being intact at all times No IOUs!
- Perforate or stamp vouchers as "PAID" to prevent their re-use, and then file them to support the replenishing of the imprest fund
- Conduct surprise petty cash counts

Loan Disbursements The main objective of the accountant in this area is to ensure that there is an accurate and up to date record for each client who is extended credit, and that his/her status is clear at all times Periodically both the main account (or the control account) in the ledger and individual client's accounts should be posted and the totals should agree

To do this, open a loan ledger with a separate page for each client In addition, two subsidiary journals will be necessary one for loan disbursements and one for loan repayments, including interest (see section 3 1) These subsidiary journals are posted in detail to the loan ledger and in summary monthly to the general ledger As soon as a disbursement is made to borrowers, an accounting entry is made on the payments side of the cash book

	Debit	Credit
Loan portfolio control account (asset account)	1,500,000	
Cash in bank (asset account)		1,500,000

The above entry is supported by a list in the loan disbursement journal of all clients whose combined balances make up the Ush1,500,000/- This journal provides a record of the loan disbursement to several borrowers as follows

	Debit	Credit
Client A	200,000	
Client B	150,000	
Client C	400,000	
Client D	250,000	
Client E	200,000	
Client F	150,000	
Client G	150,000	
Loan portfolio control account	1,500,000	
Cash in bank (asset account)		1,500,000
	1,500,000	1,500,000

Each client or group (depending on the methodology used) will also have a ledger card or an account in a subsidiary ledger and periodically all entries in the loan disbursement journal will be posted to their respective accounts in the subsidiary ledger Periodically the main account (or the control account) should be reconciled with the subsidiary ledger

Loan disbursements are particularly susceptible to fraud and theft Therefore, management must establish appropriate control measures The main objective is to ensure that credit is given only to bona fide clients that have been assessed by the MFI according to MFI policies and procedures Additionally, management must take care that the money actually reaches the borrowers, is secure against fraud and robbery, that the MFI is secure from inside borrowing, that the MFI has a delinquency management system in place, and that there is minimum delay between the time credit is approved and delivered

A number of measures can be instituted to safeguard the clients and the MFI from problems connected with loan disbursements

- **Draft Official Policy** An official policy, embodied in the MFI's 'Credit Policies and Procedures Manual', must be adopted outlining procedures for processing and approving clients' applications The policy must address issues like who is entitled to receive loans, credit limits, collateral requirements, interest rate and fee structure, the loan application process, loan repayment terms and delinquency management policy

- **Improve Efficiency** The credit officers and staff should ensure that a client's application is duly processed and approved in compliance with policy before a disbursement is made This should be done with minimum delay

- **Diversify Staff Involvement** Responsible officials of the MFI other than the loan or credit officers should be involved in loan disbursements

- **Rotate Staff** Credit officers and branch managers should be rotated from time to time

- **Establish a Direct Deposit System** Request borrowers to open bank accounts at a convenient commercial bank, and make loan disbursements directly via the borrowers' bank accounts

Procurement of Fixed Assets The accountant must ensure that there is an accurate and up-to-date record of all fixed assets To do this, accounts are created in the Chart of Accounts for various categories of fixed assets, e g Motor Vehicles, Equipment, Furniture, Fixtures and Fittings, Computers, Buildings, etc Then, whenever a fixed asset is purchased, an appropriate entry is made in the cash book

	Debit	Credit
Motor vehicles (asset account)	8,000,000	
Cash in bank (asset account)		8,000,000

Details of the purchase should be entered in the vehicle file and Fixed Assets Register

Internal controls must be established to guard against fraudulent acquisitions and use Management and the accounting staff must ensure that fixed assets are acquired with proper authority, that they are properly accounted for and recorded, that they are maintained and used only for MFI business purposes When it is time to eliminate a fixed asset, disposal must be properly authorized and the proceeds accounted for and recorded

Management should consider doing the following

- Ensure that there is a budgetary process that would form the basis of authorizing the initiation of the procurement process and transaction

- Ensure that there is a documented procurement policy in place and that it is followed

- Detail in the procurement policy the formation of a procurement committee and outline its responsibilities

- Include safeguards in procurement policy, such as a requirement that there be authorization at the Board level for purchasing fixed assets outside the budget

- Label all fixed assets legibly and indelibly

- Create a fixed assets register listing the following information asset type, description (model, brand, color), serial number, asset number, date of purchase and purchase price, supplier, location and officer in charge of the asset See 4 4 for a sample fixed assets register

- Inspect fixed assets regularly, comparing what is found with the fixed assets register A responsible official who is not involved in the procurement or recording process of fixed assets should do this once or twice a year

- Establish a documented policy regarding the disposal or writing off of fixed assets The policy can specify the value over which disposal must be approved by the Board As an example, an asset valued at USh500,000/- or more would have to be considered by the Board or senior level management

Purchases of supplies (stationery and other consumables) The accountant must ensure that there is an accurate record of all supply expenses in the books of the MFI On the basis of available source documents, make appropriate entries in the books of original entry When payment is made for a purchase, an entry would be made in the right side of the cash book by crediting cash and debiting office stationery If payment is not made immediately but the MFI has taken possession of the supplies, then an entry would be made in either the purchases journal or in the general journal The office stationery account would be debited and the supplier of the stationery would be credited When the payment is made, an entry would be made in the cash book by debiting the supplier of stationery and crediting cash

Again, the objective of internal controls is to guard against fraudulent acquisitions and misuse Goods and services should be ordered only in the quantity and quality needed, and at the best terms available All items must be properly requisitioned Be sure that all received goods are inspected, all invoices are checked against authorized purchase orders and the supplier's delivery notes, and that the items are in good condition at delivery Record all goods and services properly and promptly

- Establish a procurement policy that details procedures for requisition of goods and services, including the procedures for obtaining tenders and competitive bids

- Be sure that all goods and service procurements fall within the budgetary control system

- Specify the personnel who are responsible for the requisition of goods and services

- Use pre-numbered order forms and keep them in safe custody Also, be certain that all goods received are recorded on pre-numbered 'received' notes

- All goods must be inspected for condition, price, quantity and agreement with the order, and then counted on receipt A responsible official should acknowledge this exercise

- There must be a procedure for dealing with rejected goods or services

- Invoices should be checked for arithmetical accuracy and pricing, and agreed with the local purchase order and the goods received notes

- Payment, which should be by cheque, must be made after all these procedures are carried out

- Responsibilities for bookkeeping should be vested in officials separate from those responsible for the ordering and receiving of goods or the inspection of services

Payroll Every MFI has employees and therefore needs to maintain a payroll The payroll process not only involves issuing paycheques, but also involves withholding a portion of all employees' salaries for PAYE, NSSF, and, depending on MFI policy, salary advances

For most MFIs, payroll represents the largest of all business costs The accounting department must ensure that the expense level is accurately established and the deductions from individual salaries are properly recorded

- Maintain a payroll account with nine columns These columns should be labeled as employee name, basic salary, allowances, gross salary, PAYE deduction, NSSF deduction, advances, net pay, and signature See section 5 5 for a sample payroll account

- Fill in the names and particulars for all staff as advised by the personnel department

- Obtain information from accounts relative to staff advances, if any

- Calculate PAYE and NSSF deductions

- Work out net pay and enter the details on a salary slip for each employee

- On payday, have cheques written out for each employee and have each employee sign for his or her cheque If possible have all salaries paid directly through the bank

- Issue each employee a copy salary slip detailing net pay calculations

- The total of the net pay column must be debited to the *salaries and wages* account and credited to *cash in bank* in the cash book

- Prepare a cheque payable to Uganda Revenue Authority for the total deducted PAYE Debit the *salaries and wages* account and credit *cash in bank* in the cash book

- Prepare a cheque payable to the NSSF for the total of all NSSF payroll deductions plus employer's contribution Debit the *salaries and wages* account and credit the *cash in bank* account

- Transfer the total of all advances paid that month to the debit side of the *salaries and wages* account

Internal controls must be established to guard against payroll fraud Policies and procedures should be established that ensure that wages and salaries are paid only to actual employees at authorized rates of pay, and that salaries and wages are computed in accordance with actual work records (attendance, time sheets, output, etc) A number of measures can help to reduce the risk of payroll fraud

- Keep separate records for each employee

- Draft a personnel policy that addresses issues like salary advances, leave pay, allowances, overtime, and bonuses

- Create a work record system that reveals employee absences This could be a sign-in/sign-out book or time cards

- Senior management (who is not involved with payroll preparation) should check and approve payroll each pay period

- Register with the NSSF and the URA-PAYE Departments Note that these deductions are statutory and it is an offense if deductions are not made and/or if they are made and not remitted Deductions should be made promptly and by cheque

- Pay all salaries by cheque or direct bank deposit

- Conduct independent comparisons of payrolls for different months, and investigate variances promptly

Periodic Payments It is important that proper accounting procedures are used for payments of periodic bills such as telephone, water, electricity, etc The accounting staff must maintain proper records of all bills and ensure that all bills in a given period are entered in the books of account Each month these payment entries should be posted to the ledger

Example A water bill for Ush120,000/- has been received Payment has been authorized and a cheque written An entry is made in the cash book The cash book category *water expenses* is debited for Ush120,000/-, and *cash in bank* has been credited The cheque is then sent to National Water and Sewerage Corporation and the bill is settled

	Debit	Credit
Water expenses	120,000	
Cash in bank (asset account)		120,000

Internal controls are essential to ensure that the MFI is correctly billed for services consumed in the period in question Require that currents bills are regularly compared with previous payments, and check to be sure that all previous payments were credited by the service provider For additional security, pay all bills by cheque See section 4 6 Cash book – The Payments Side for a sample cash book record of payments

3.4 END OF ACCOUNTING PERIOD JOURNAL ADJUSTMENTS

Certain transactions take place in an organization without immediate exchange of cash These are not normally included in the books of account during the accounting period Also, at the end of an accounting period, adjustments of some account balances in the ledger must be made before the financial statements can be prepared In order to make the financial records complete, it is necessary to include all such transactions and adjustments and to make appropriate adjustments to the ledger balances This accounting procedure is called *end of accounting period journal adjustments*

To exclude such adjustments would render the accounts records incomplete and the financial statements misleading The Balance Sheet must contain *all* assets, liabilities and capital at the close of business on the last day of the accounting period The P&L/I&E Acct must contain *all* the revenue and expenses applicable to the period covered but must not contain any revenue or expenses relating to the following period

End of accounting period journal adjustments include

- Accruals
- Prepayments
- Loan losses
- Write off of bad debts
- Depreciation
- Error corrections
- Adjustments to capital and deferred revenue grants
- Interest income due to stakeholders

Each will be covered in detail

Accruals Accrual accounting is the process of recognizing revenue in the period in which it is earned and deducting the expenses incurred in generating this revenue Since these expenses have been incurred, and the revenue has been earned, there is a need to record them in the books

Adjustment entries are made at the end of each accounting period to record any expenses that have been incurred but have not been recognized elsewhere in the accounts An example is a periodic expense like rent or telephone for which bills have been received but not paid by the closing date Another example is recognized interest on borrowed money

There could also be income that has been earned but not yet received and therefore not recorded by the time financial statements are prepared However, for MFIs it is correct to recognize receivable interest (income) when it is actually received, rather than to accrue it

The accounting objective is to ensure that revenue is matched with the related expenses incurred in obtaining that revenue After ascertaining the various incurred expenses and earned revenues, make the necessary book entries in the general journal Assume a calendar year accounting period for all examples below

Example On 23 December the MFI receives a telephone bill of USh125,000/- for the last two months of the financial year The MFI does not pay the bill until January (in the next financial year) This telephone bill must be accrued in the year to which it relates In this case it is the telephone bill payable for November and December

	Debit	Credit
Telephone/faxes (expense account)	125,000	
UP&TC (accounts payable)		125,000

Internal controls related to accruals should ensure that the expenses or the income have been properly accrued The accounting staff should be careful that all journal entries are supported by authentic source documents that are properly checked and filed The journal entries must be approved by a senior official in the accounts department before being posted to the ledger

Prepayments These are payments that have been made in advance for items that spread across two accounting periods Two examples are rent and insurance At the end of the accounting period, a portion of these two services will have expired or will have been consumed, but another portion will remain unused The portion of the expenditure that has expired is an expense of the current period The unused portion of the rent or insurance represents an asset at the Balance Sheet date, and will not become an expense until a later accounting period A period-end adjustment is necessary to establish the expense for the period and the prepayment for the next accounting period

Example At the beginning of November the MFI buys a comprehensive insurance policy for its vehicles renewable every year at a premium of USh3,000,000/- per year On average the premium is USh250,000/- per month The accountant made the following entry in the cash book in November to account for the insurance payment

	Debit	Credit
Prepaid insurance (asset account)	3,000,000	
Cash in bank (asset account)		3,000,000

By 31 December, two months of the insurance policy would have expired and would constitute an expense for the current period Therefore, at the close of the accounting period the following journal adjustment needs to be made to record the insurance expense for the current period

	Debit	Credit
Insurance expense (expense account)	500,000	
Prepaid insurance (asset account)		500,000

This adjusting entry serves two purposes It apportions the proper amount of insurance expense for the current period and it reduces the asset account (the prepaid insurance account) to the correct amount of prepaid insurance (unused) that would appear on the 31 December Balance Sheet

Loan Loss Provision *Loan Loss Expense* and *Loan Loss Provision* are accounting entries which represent the amount of outstanding principal that is not expected to be recovered by the MFI The amount of provision is a management decision normally based on historical information regarding loan default and aging analysis and according to the policy of the MFI An aging analysis should be calculated periodically to determine whether a loan provision needs to be made or adjusted

The accountant's objectives are to ensure that the provision has been given proper treatment in the books of account The provision is made in the general journal

Example Assume a loan portfolio of USh250m/- and a loan loss provision of 5% (USh12,500,000/-) An entry needs to be made and posted to the general ledger as provision for loan loss at the end of the year

	Debit	Credit
Loan loss expense (expense account)	12,500,000	
Loan loss provision (negative asset account)		12,500,000

The loan loss provision is reflected as a deduction from the loan portfolio asset on the Balance Sheet This serves to reduce the outstanding loan portfolio to its estimated realizable value in the Balance Sheet The loan loss expense is a cost that will reduce profit/surplus in the P&L/I&E account

Internal controls must be established to ensure that adequate loan loss provision has been made One way to be certain of this is to do an aging analysis of the loan portfolio each month

Write-off of Bad Loans MFI management should have a documented policy for writing off loans This policy should address processes such as adequate visitation and communication between the borrower and the MFI, and legal procedures such as court action MFI policy should also specify the senior management responsible for reviewing and authorizing loan write-offs

A write-off will take place according to MFI policy when it is determined that certain loans cannot be recovered Write-offs only occur as an accounting entry and do not mean that loan recovery efforts should not continue

Example Assume that the MFI has learned that a loan of USh500,000/- from Customer X is unlikely to be recovered An entry must be made in the general journal to account for this loan

	Debit	Credit
Loan loss provision (negative asset account)	500,000	
Loan portfolio (asset account)		500,000

Also, show the write-off in the subsidiary ledger on the account of Customer X

In this case, the accounts in the general ledger that will be posted are both Balance Sheet accounts The profit and loss account is not affected since this write-off was covered in the earlier entry providing for loan loss As a result, the net portfolio is left unchanged on the Balance Sheet since the loan loss provision has already been made If the loan loss provision is too low relative to the value of irrecoverable loans, then it needs to be increased through making a provision for loan losses on the profit and loss account

Depreciation The recorded costs of fixed assets are gradually expiring with the passage of time Before financial statements are prepared, the financial records of the MFI must be brought up-to-date with respect to depreciation Accounting policy and procedure must ensure proper accounting for depreciation

Example A vehicle is purchased for USh8,000,000/- This vehicle will have a useful life of 5 years and a salvage value of USh2,000,000/- Using the straight line method of depreciation, the amount would be USh1,200,000/- per annum (8m less 2m = 6m divided by 5 = 1 2m) After determining the amount of depreciation, an accounting entry is made in the General Journal

	Debit	Credit
Depreciation expense/motor vehicles (expense account)	1,200,000	
Accumulated depreciation account (negative asset		1,200,000

The depreciation expense will be reflected in the P&L or I&E account and the Accumulated Depreciation Account will appear as a negative asset (a deduction) in the *Asset* section of the Balance Sheet under the appropriate fixed asset account Acceptable practice is to show fixed assets at their net book value, i e net of accumulated depreciation

Unlike the loan reserve account, the accumulated depreciation account is not intended to reduce the fixed assets account to realizable value but merely to show what portion of the original cost has expired and therefore been expensed

Error Corrections At different stages in the accounting cycle, errors in the accounting process can be made If there are sufficient in-built controls in the system, errors should be detected There are accounting procedures to correct these errors

Example A computer operator of the MFI requisitions for computer stationery costing USh500,000/- Supplier A makes the delivery and is paid The bookkeeper erroneously makes the following entry in the cash book

	Debit	Credit
Staff salaries	500,000	
Cash		500,000

At the end of the accounting period, the senior accountant checks and analyzes the various ledger accounts S/he discovers the error S/he cannot cross out the error in the cash book but will instead make the following entry in the General Journal

	Debit	Credit
Computer stationery	500,000	
Staff salaries		500,000

This entry corrects the error previously made in the cash book by debiting computer stationery instead of staff salaries

Adequate internal controls should ensure that error correction is done properly Have a senior accountant not involved in record keeping or an internal auditor check the different stages of the audit trail Require approval of error corrections before posting them to the General Ledger

Adjustments to Capital and Deferred Revenue Grants International Accounting Standard 20 recommends that some types of grants be recognized in the P&L/I&E Statement on a systematic and rational basis over the periods necessary to match them with the related costs Capital grants related to depreciable assets are allocated to income over the period and in the proportions in which depreciation on those assets is charged Likewise, grants that are related to operating expenses should be recognized in the period in which the related costs are incurred

International Accounting Standard does not comment on grants for loan funds The CMF recommends that initially they be treated as capital and therefore not allocated to income When loans made against that grant are found to be irrecoverable, they will be written off, and the Loan Fund Capital Account reduced by the same amount

We present three examples of adjustments for three major types of grants

Example One – Grant for Fixed Assets A capital grant of USh50,000,000/- is given for the purchase of motor vehicles Assuming a useful life of 10 years, no salvage value and a straight-line method of depreciation, the following entries will be made in the MFI's records The first entry denotes the grant received for the purchase of the vehicles

	Debit	Credit
Cash in bank (asset account)	50,000,000	
Capital grant (capital account)		50,000,000

A second entry is made indicating the actual purchase of the motor vehicle according to the grant agreement

	Debit	Credit
Motor vehicles (asset account)	50,000,000	
Cash in bank (asset account)		50,000,000

These entries are made at the time the grant is received and the purchase made by the MFI Refer to the Receipts and Payments sections of this guideline They are repeated here for the sake of clarity

Continuing with this example certain adjustments need to be made at the end of the year First, an adjustment must be made in the general journal From the information above, depreciation would be Ush5 000,000/- per year The first adjustment is provision for depreciation of the motor vehicle

	Debit	Credit
Depreciation expense (expense account)	5,000,000	
Accumulated depreciation (negative asset account)		5 000,000

The second adjustment is a transfer of a portion of the grant to the profit and loss account

	Debit	Credit
Capital grant (capital account)	5,000,000	
Grant revenue account		5,000,000

These two entries would be made every year for the lifetime of the motor vehicles In this case, the entries would be made each year for ten years

Example Two – Grant for Operations A grant of Ush50,000,000/- has been given to cover the salary of an advisor In the cash book, an entry needs to be made as a record of the receipt of these funds Note that the entry is made at the time the grant money is received

	Debit	Credit
Cash in bank (asset account)	50,000,000	
Deferred income (liability account)		50,000,000

For two years the advisor is paid Ush2,000,000/- per month and the balance is to be paid as gratuity at the expiration of the contract The following entry is made when payment is actually made to the advisor

	Debit	Credit
Advisor salary	2,000,000	
Cash in bank (asset account)		2,000,000

Assuming that the calendar year is used as the MFI's accounting period and that the payment began in January, the accountant must make the following adjustment entry in the books at year-end

	Debit	Credit
Deferred income (liability account)	24,000,000	
Grant income (revenue account)		24,000,000

The advisor s salary for the entire financial year is allocated at the end of the financial year to the grant income account from the deferred income account This adjustment entry is made at every year-end until the grant expires

Example Three – Grant for Loan Funds A grant of Ush150 000 000 is received for the loan fund As loans are given out some clients default and their loans are not recovered This means that the loan fund reduces in money value and this reduction must be reflected in the accounts to show the reality of the situation

The entire series of accounting entries relative to this grant is shown below On receipt of the grant an entry is made in the cash book, as demonstrated in the receipts section of these guidelines It is repeated here for the sake of clarity

	Debit	Credit
Cash in bank (asset account)	150,000,000	
Loan fund grant (capital account)		150,000,000

As the MFI makes the loans, this entry is made

	Debit	Credit
Loan portfolio (asset account)	150,000,000	
Cash in bank (asset account)		150 000,000

When some of the clients repay the principal amount, the following entry is made

	Debit	Credit
Cash in bank (asset account)	75,000,000	
Loan portfolio (asset account)		75,000,000

When these same clients pay interest and fees

	Debit	Credit
Cash in bank (asset account)	11 250,000	
Interest/fees on portfolio (revenue account)		11 250 000

When the MFI makes a provision for loan losses

	Debit	Credit
Loan loss (expense account)	7 500 000	
Loan loss provision (negative asset account)		7,500 000

Note that the loan loss provision is a negative asset account that is set off against the loan portfolio

When the MFI recognizes that some loans are irrecoverable (totaling Ush3,000,000/-), this entry is made

	Debit	Credit
Loan loss provision	3,000,000	
Loan portfolio		3,000,000

To reflect the reduction of the loan portfolio in money terms, the following entry is made

	Debit	Credit
Loan fund grant (capital account)	3 000,000	
Grant revenue account		3,000,000

Note that some MFIs will opt not to make this last entry and in this case the fund is left intact This is a conservative approach but does not strictly reflect the reality of the reduction in the value of the loan fund

Internal controls should be in place to ensure that appropriate adjustments are made at the end of the accounting period Before they are posted to the general ledger, a senior staff member who has proper understanding of the nature and conditions of the grant should approve all journal adjustments

Adjustments for interest income due to stakeholders In some cases grants are given with a requirement that the MFI repay any earned interest on funds not put to immediate use e g in the form of deferred revenue In that case the MFI must properly account for this interest income and pay it to the stakeholder Earned interest is reflected in the bank statements The bank should advise the MFI via a credit note for the amount earned

Example Assume that the interest earned on unused grant funds is USh600,000/- The following entry must be made in the general journal as a record of the interest earned on the grant

	Debit	Credit
Cash in bank (asset account)	600,000	
Accounts payable/interest due		600,000

When the interest is actually paid to the stakeholder, the following entry is made

	Debit	Credit
Accounts payable/interest due	600,000	
Cash in bank (asset account)		600,000

Internal controls should be established that will ensure that stakeholders are paid only what is due to them Open separate accounts for all grants requiring the repayment of earned interest See section 4 7 for a sample of the general journal including earned interest

3.5· PREPARATION OF FINANCIAL STATEMENTS

It is the responsibility of the accounting staff to prepare financial statements that are correct, understandable and admissible for all users Financial statements used by outsiders must be in accordance with the International Accounting Standards Senior management should establish reasonable deadlines for the preparation and submission of financial statements, and the accounting staff should ensure that the statements are prepared in a timely manner Accounting procedures can be outlined as follows

- Prepare the trial balance from the general ledger
- Close and transfer all revenue and expense account balances to the P&L/I&E statement

Please note that all revenue accounts have credit balances and expense accounts have debit balances By transferring the balances from the revenue and expense accounts to the profit and loss statement, the accounts are effectively closed Thus, all revenue accounts are debited and the profit and loss statement is credited Likewise, all expense accounts are credited and the profit and loss statement is debited

Example One – Revenue Account

	Debit	Credit
Interest on loans	70,000,000	
Profit and loss account		70,000,000
Being the closing off of the interest on loan revenue account to the profit and loss account		

All revenue accounts would be closed off to the profit and loss statement in a similar manner

Example Two – Expense Account

	Debit	Credit
Profit and loss account	30,000,000	
Salaries and benefits		30,000,000
Being the closing off of the salaries and benefits expense account to the profit and loss statement		

All expense accounts would be closed off to the profit and loss statement in a similar manner

- On the P&L/I&E statement, deduct expenses from revenue This results in net surplus or deficit (profit or loss) Transfer it to the Balance Sheet as net surplus/(deficit) - current year

- Transfer the balances on the balance sheet accounts to the appropriate sections of the Balance Sheet

See Flow Chart 1 in Section 2 2 for the relationship between the P&L/I&E Statement and the Balance Sheet See a sample Balance Sheet in 5 3 The Balance Sheet, and a sample profit and loss statement in 5 4 The Profit and Loss Statement

Please note that at the end of the accounting period, after transferring all balance sheet account balances to the Balance Sheet, the accounts in the general ledger are ruled off to mark the end of the current period and the beginning of a new period

- Prepare notes
    - Accounting Policies of the MFI
    - Schedule of depreciation of fixed assets that shows the fixed assets at cost, the accumulated depreciation, any disposals and the book value of fixed assets
    - Any schedules that support the figures in both the Balance Sheet and the P&L/I&E Statement
    - Other information that will make the financial statements comprehensible
- Present the Financial Statements to the users
- From the prepared Balance Sheet prepare an opening Trial Balance The balances from the Balance Sheet form the opening balances for the next accounting period

Internal controls must be established so that financial statements are accurate and complete, and that the statements are timely

Management should ensure that the accounting department is adequately staffed with people with the required skills The process of preparing the financial statements should be adequately supervised at every critical stage For additional control, have the financial statements audited

CHAPTER 4: TABLES

4 1. LEDGER ACCOUNT

Ledger account Cash ın Bank A/C No 101

Date	Explanatıon	Ref	Debıt	Credıt	Balance
1 1 97	Balance B/F from 1996		2,500,000		2,500,000
31 1 97	Varıous bankıngs made ın January per cash book	CB1	301,000,000		303,500,000
31 1 97	Varıous payments made ın January per cash book	CB2		165,490,000	138,010,000

4 2: DEBIT & CREDIT EFFECTS ON ACCOUNTS

Effect of debıt & credıt on dıfferent categorıes of accounts

Generıc account category	**A debıt to an account wıll**	**A credıt to an account wıll**	**Normal balance wıll be**
Revenue	- Decrease	+ Increase	Credıt
Expense	+ Increase	- Decrease	Debıt
Asset	+ Increase	- Decrease	Debıt
Lıabılıty	- Decrease	+ Increase	Credıt
Capıtal	- Decrease	+ Increase	Credıt

4 3 CASH BOOK – THE RECEIPTS SIDE

		Debit Bank	Credit the Various Sources of Funds						
Date	Particulars	Amount	Capital (Owner's)	Capital (Grant)	Capital (Loan Fund)	Deferred Revenue	Interest Income	Loan Portfolio	Clients' Savings Deposits
2 1 97	Being receipt of check no xx from Director A as own contribution	50,000,000	50,000,000						
5 1 97	Being grant of USh250,000,000 for the loan fund, purchase of MV and payment of salary to Advisor	250,000,000		50,000,000	150,000,000	50,000,000			
10 1 97	Being banking of cash from various borrowers as loan repayments as per daily cash receipt summary (see daily cash receipt summary file) and bank pay-slip (see bankings file)	2,500,000						2,500,000	
10 1 97	Being banking of cash from various borrowers as interest income per daily cash receipt summary (see daily cash receipt summary)	600,000					600,000		
15 1 97	Being banking of cash from various clients as savings deposits per daily cash receipt summary	600,000							600,000
30 1 97	Being check no XX from Central Bank as income on 90 day Treasury Bill	1,000,000					1,000,000		
	Totals	304,700,000	50,000,000	50,000,000	150,000,000	50,000,000	1,600,000	2,500,000	600,000

4 4: FIXED ASSET REGISTER

Asset Type	Number	Asset Description (model brand, color)	Serial Number/ Asset Number	Date of Purchase	Purchase Price	Officer Responsible	Location	Disposal Proceeds	Depreciation Year 1	Depreciation Year 2	Depreciation Year 3	Depreciation Year 4	Depreciation Year 5

4.5: PAYROLL

Name	Basic Pay	Housing Allowance	Others	Gross Pay	PAYE	NSSF	Advances	Total Deductions	Net Pay	Signature

4.6. CASH BOOK – THE PAYMENTS SIDE

		CREDIT	DEBIT						
Date	Particulars	Bank	Petty Cash	Loan Disbursements	Salaries and Wages	Office supplies/ office expenses	Fixed Assets	Staff Advances	Motor Vehicle Running Expenses
2 1 97	Being creation of petty cash fund	500 000	500,000						
3 1 97	Being various payments from petty cash		(282 000)						
	Fuel for field vehicles								35 000
	Office expenses sugar					5 000			
	Office supplies					37,000			
	Casual labor				85 000				
	Staff advance							120 000	
7 1 97	Being record of loans to various borrowers	150 000 000		150 000 000					
20 1 97	Being purchase of new motor vehicles	50 000 000					50 000 000		
21 1 97	Being purchase of stationery	450 000				450 000			
28 1 97	Being salary cheque for net pay (see payroll)	4 500 000			4,500 000				
29 1 97	NSSF deductions and MFI s contribution	900 000			900 000				
29 1 97	Being PAYE deductions remitted to URA	1 020 000			1 020 000				
Totals		207 370 000	218 000	150 000 000	6 505 000	492 000	50 000 000	120 000	35 000

4 7· THE GENERAL JOURNAL

Date	Account Titles and Explanation	LP	Debit	Credit
31 12 97	Telephone expense	12	125,000	
	Accounts payable	24		125,000
	Being accrued telephone expense for the month of Nov and Dec See bills file			
31 12 97	Interest revenue receivable	15	10,000	
	Interest revenue	30		10,000
	Being interest revenue earned for the month of December			
31 12 97	Loan loss expense	35	12,500,000	
	Loan loss provision	40		12,500,000
	Being provisions for loan loss in 1997			
31 12 97	Loan loss provision	40	500,000	
	Loan portfolio	14		500,000
	Being write-off of a loan			
31 12 97	Loan fund capital	15	500,000	
	Revenue account (Grants)	26		500,000
	Being loan written off against original funding			
31 12 97	Depreciation expense - motor vehicles	31	1,200,000	
	Accumulated depreciation - MV	37		1,200,000
	Being provision for depreciation for MV for 1997			
31 12 97	Insurance expense	24	500,000	
	Prepaid insurance	12		500,000
	Being record of insurance expense for 1997			
31 12 97	Computers stationery	23	500,000	
	Staff salaries	17		500,000
	Being correction of error previously made in cash book			

The LP (ledger page) just to the left of the debit column is left blank at the time of making a journal entry When the debits and credits are later posted to the ledger accounts, the page numbers of the ledger accounts are listed to provide a convenient cross-reference with the ledger

CHAPTER 5: APPENDICES

5.1: CHART OF ACCOUNTS

ASSETS

101	Petty Cash
102	Cash in Bank
103	Short term investments (deposits)
104	Prepayments
105	Loan portfolio
106	Long term investments
107	Fixed assets (one for each class of asset)
108	(Accumulated depreciation)

LIABILITIES

201	Short-term borrowing
202	Client savings
203	Long-term debt (commercial)
204	Long-term debt (concessionary)
205	Restricted/deferred income

CAPITAL

301	Loan fund capital
302	Grant capital (fixed assets)
303	Owner's capital
304	Retained net surplus/(deficit) prior
305	Current year net surplus/(deficit)

REVENUE

401	Interest on portfolio
402	Fees/service charges
403	Interest on investments
404	Grant income
405	Donations and fundraising

EXPENSES

501	Interest paid on short-term borrowings
502	Interest paid on long-term debt
503	Interest paid on client savings
504	Loan losses
505	Salaries and benefits
506	Telephone and faxes
507	Courier/postage
508	Rent
509	Utilities
510	Depreciation
511	Bank charges
512	Advertising and promotion
513	Insurance
514	Supplies
515	Maintenance
516	Travel and accommodation
517	Legal fees

518	Auditor's fees
519	Computer stationery and maintenance
520	Volunteer expenses
521	Miscellaneous

5.2 PROCEDURE FOR PREPARING BANK RECONCILIATIONS

The balance shown on the monthly statement from the bank will usually not agree with the balance of cash shown on the depositor's accounting records The bank will not yet have recorded certain transactions recorded by the depositor The most common examples are

- Outstanding cheques These are cheques written by the customer (in this case, the MFI) and deducted in the MFI's records but not yet presented to the bank for payment and deduction

- Deposits in transit

- Unaccredited remittances or lodgments

The customer has not yet recorded transactions that may appear on the bank statements

Examples are

- Bank charges and commissions

- Standing orders

- Direct credits e g from investors or donors

In some cases, bank reconciliation will be completed after such items as outstanding cheques, deposits in transit and miscellaneous bank charges have been taken into account Other cases may require the correction of errors by the bank or by the customer to complete the reconciliation

Procedure

- Check that all deposits in transit listed in last month's bank reconciliation statement are included in the current month's bank statement

- Compare the deposits listed on the bank statement with the deposits shown in the MFI's records on the left hand side of the cash book Place check/tick marks in the MFI's cash book *and* on the bank statement beside the items which agree Any unchecked item in the MFI's cash book of deposits are deposits not yet recorded by the bank and should be added to the balance reported by the bank

- Be sure that the cheques listed as outstanding in the bank reconciliation for the preceding month have been paid in the current month If not, such cheques should be listed as outstanding in the current reconciliation

- Check the payment side of the cash book and compare each cheque with the corresponding entry in the bank statement As in the above exercise, place a check mark against each payment that appears in the bank statement when the cheque number and the amount agree Unmarked cheques are then listed in the bank reconciliation as outstanding cheques to be deducted from the balance reported by the bank

- Deduct from the balance in the MFI's records any standing-order payment that was paid by the bank but not recorded by the MFI
- Add to the balance per the MFI's records any credit recorded by the bank but not yet recorded by the MFI
- Prepare the bank reconciliation statement, as illustrated below
- Make journal entries for any valid item on the bank statement has not yet been recorded in the MFI's cash book

Sample Bank Reconciliation Statement

Balance per bank statement			xxxxxxx
Add deposits in transit (uncredited lodgments)			
Item		Amount	
X		xxxxx	
X		xxxxx	
			xxxxxxx
			Total
Subract outstanding cheques			
Cheque number	Payee	Amount	
Xxxx	xxxx	xxxxx	
Xxxx	xxxx	xxxxx	
Xxxx	xxxx	xxxxx	xxxxxxx
			Total
Add bank charges not yet recorded in the MFI cash book			xxxxxxx
			Total
Subract any other payments made directly by bank on behalf of MFI			xxxxxxx
Balance in cash book			xxxxxxx

The final total should match the total in the MFI cash book Any valid item on the bank statement, e g bank charges, commissions, or any other payment on behalf of the MFI which has been identified in the process of reconciliation, must be entered in the MFI's cash book before the closure of the books for that period

5.3: THE BALANCE SHEET

ABC CREDIT PROGRAM

Balance Sheet at December 31,	1996		1995
ASSETS			
Long Term Assets			
Fixed assets (net book value)		50,000,000	60,000,000
Long term investments		50,000,000	50,000,000
Total Long Term Assets		100,000,000	110,000,000
Current Assets			
Cash and bank balances	5,000,000		3,000,000
Short term deposits	8,000,000		8,000,000
Net loan portfolio	384,000,000		350,000,000
Total Current Assets	397,000,000		361,000,000
Current Liabilities			
Commercial loan	9,000,000		10,000,000
Concessionary loan	25,000,000		26,000,000
Deferred revenue	25,000,000		27,500,000
Client savings	20,000,000		15,000,000
Total Current Liabilities	79,000,000		78,500,000
NET CURRENT ASSETS		318,000,000	282,500,000
TOTAL NET ASSETS		418,000,000	392,500,000
LESS LONG TERM LIABILITIES			
Commercial loan	9,000,000		10,000,000
Concessionary loan	25,000,000		26,000,000
Deferred revenue	25,000,000		27,500,000
Total Long Term Liabilities		59,000,000	63,500,000
NET WORTH		359,000,000	329,000,000
Financed by			
CAPITAL			
Loan fund capital		220,000,000	220,000,000
Capital grant (fixed assets)		20,000,000	30,000,000
Other capital		30,500,000	30,000,000
Retained profits (prior years)		49,000,000	20,100,000
Retained profits (current year)		39,500,000	28,900,000
		359,000,000	329,000,000

5.4 THE PROFIT AND LOSS STATEMENT

Profit and Loss Statement for December 31,	1996 Ush	1995 Ush
REVENUE		
Interest on loans	74,500,000	65,000,000
Fees and commissions	15,000,000	10,000,000
Investment income	500,000	400,000
Total Revenue	90,000,000	75,400,000
FINANCIAL COSTS		
Interest on debt	7,000,000	7,500,000
Interest on client's savings	1,000,000	500,000
Total Financial Costs	8,000,000	8,000,000
(Revenue less Financial Costs =)		
Gross Financial Margin (less)	82,000,000	67,400,000
Loan Loss Provision (equals)	2,000,000	1,500,000
NET OPERATING MARGIN	80,000,000	65,900,000
OPERATING EXPENSES		
Salaries and benefits	30,000,000	28,000,000
Administrative expenses	3,000,000	2,500,000
Office rent	4,000,000	4,000,000
Travel	500,000	450,000
Depreciation	10,000,000	10,000,000
Motor vehicle running expense	4,000,000	3,500,000
Motorcycle running expense	2,000,000	1,500,000
Telephone and faxes	600,000	650,000
Courier and postage	400,000	400,000
Auditor's fees	1,000,000	1,000,000
Total Operating Costs	55,500,000	52,000,000
(net margin less total costs equals)		
Net Income from Operations (plus)	24,500,000	13,900,000
Grant Revenue (equals)	15,000,000	15,000,000
Excess of Revenue over Expenses	39,500,000	28,900,000

5 5 GLOSSARY

The primary source for this glossary is Nicola Elliot, <u>Basic Accounting for Credit and Savings Schemes</u> This book is available in the CMF library

Accounting Accounting is a service that provides financial information about an organization's economic activities in a manner that will facilitate decision-making Bookkeeping is the record-making phase of accounting

Accounting period The period of time covered by financial statements The accounting period is set to suit the needs of managers of the organization best, and may vary between organizations Generally, the accounting period refers to one fiscal/financial year, one quarter (3 months) or one month

Accruals basis of accounting This is when income is recorded when earned and expenses recorded when incurred, rather than when actually received or paid

Assets Physical things owned by an individual or organization including petty cash, cash in bank, loan portfolio, office equipment, vehicles, etc

Audit (external) An independent examination and expression of opinion on the accounts and the underlying records of an organization by an accountant independent of the enterprise

Bad debt A loan that cannot be recovered

Balance An amount remaining on an account at a certain point in time

Balance sheet A financial 'photo' which shows what an organization owns and owes at any one time Essentially it is a list of assets on one side and a list of liabilities on the other side, along with the amount or value of each

Bank statement A report issued by the bank detailing the transactions of a customer's bank account with that bank

Bank reconciliation This is the exercise of comparing and *reconciling* (agreeing) the cash in bank balance as shown in the customer's cash book with the balance shown on the customer's bank statement It is the investigation of the difference (if any) between the two balances

Bookkeeper The person responsible for writing and maintaining books of account in an organization He/she is responsible for the record-making phase of accounting

Budget This is the costed plan of an organization that shows the projected income and expenditure of an organization for a specified time period

Budget and actual report A comparison of budgeted income and expenditure against actual income and expenditure for an accounting period

Capital This includes capital contributions by any investors or donors, retained earnings, and the current year surplus It includes grants that do not have to be paid back

Capital expenditure Expenditure on assets such as equipment, furniture or vehicles that benefit an organization for more than a year

Capitalization Funds used to commence an undertaking or needed to continue its on-going development

Cash basis of accounting This is when cash income and expenditure is recorded only when received and expense recorded when paid This is not a generally accepted accounting principle

Cash book The record of bank transactions of an organization All cash coming in and going out of the bank is recorded in the cash book

Cash count Counting cash, usually to ensure the amount held agrees with the balance shown in the cash book

Cashier The person responsible for cash handling, including receiving and paying

Chart of Accounts The listing of the account titles and their respective account numbers used in an organization

Client savings (deposits) Both voluntary and compulsory client savings that have been deposited with the organization, which an organization must return Although a liability for the organization, deposits are different from borrowed funds because there is a due date or amortization schedule Generally organizations pay a rate of return on clients' savings (deposits)

Creditor A person or group who is entitled to receive money from an organization as a result of rendering services or supplying goods to the organization

Current assets These are assets that are readily convertible to cash within the operating cycle of the MFI, and which would not exceed a year

Debtor A person or group who owes money to an organization

Deficit A deficit occurs when the amount of expenditure exceeds income in an accounting period of an organization

Depreciation Process which aims, in a systematic and rational manner, to distribute the cost or value of tangible capital assets, less salvage value if any, over the estimated useful life of the unit It is the process of allocation, not valuation Depreciation for the accounting period is charged to income

Depreciable assets These are assets which a) are expected to be used during more than one accounting period, b) have a limited useful life, and c) are held by an enterprise for use in the production or supply of goods and services, for rental to others, or for administrative purposes

Division of duties Otherwise known as internal check, this is the distribution or delegation of accounting tasks so that no one person is responsible for all procedures

Expenses These represent costs incurred for goods and services used in the process of earning revenue They are often referred to as the 'cost of doing business' since they represent the costs that are necessary for the organization to generate revenue and thus remain in operation Examples include operating costs, financing costs, loan loss provision and notional, imputed or calculated costs of capital

Fixed assets These are capitalized costs (expenditure) the benefits of which exceed one year Donated fixed assets should be recorded at their fair value at the date of the gift Organizations that have not previously capitalized their fixed assets should do so on a retroactive basis In the absence of actual historical cost information, the assets should be stated at estimated historical cost, based on a professional appraisal or other acceptable method, with subsequent additions at cost The basis of valuation should be disclosed in the financial statements

General ledger The entire group of ledger accounts is called the general ledger

Income and expenditure account A schedule explaining how the surplus generated or deficit incurred by a not-for-profit organization was achieved

Inflation A measure of the increase in the general level of prices

Invoice A bill issued by a supplier to a customer

Liabilities Amounts owed by an individual or organization to another individual or organization

Long-term debt (commercial rate) The outstanding amount that the organization owes to a bank or other lender for which it is paying a market rate of interest Long term is defined as that which has a term greater than one year

Long-term debt (concessionary rate) The outstanding amount that the organization owes a bank or other lender for which it is paying the lender a rate of interest below market rate for a term greater than one year

Net assets The total assets of an organization when the total liabilities have been paid

Net surplus/(deficit) current year The amount of income (or loss) generated in the current year

Owner The person or persons holding the share-capital in a Limited Company, or having the right to call an undertaking their legal property

Payment voucher An internal document used to record the details of a payment

Profit and loss account A schedule explaining how the profit generated or loss incurred by a commercial organization was achieved

Receipts and payments report A summary of income received and payments made during an accounting period

Receipt voucher Document issued by someone receiving money to the person from whom they receive it

Reducing balance A method of depreciating an asset whereby a percentage is deducted from the net book value of an asset at the end of the previous accounting period

Retained net surplus/(deficit) prior years The amount of income (or loss) accumulated since the formation of the organization It may also be referred to as undistributed profits or earned surplus

Restricted/Deferred funds Funds received but restricted for use in future years are classified as a liability on the balance sheet because they must be returned to the funding agency if the specified programs are not carried out When the organization receives restricted or deferred funds, it incurs an obligation (liability) to provide the services described in the grant agreement As the organization provides the services it incurs expenses Deferred revenue is then reflected as grant revenue and used to cover those expenses

Revenue In accounting terms, revenue refers to money received or to be received by the organization for goods sold or services rendered during a given accounting period Revenue for an MFI includes interest earned on loans to clients fees earned on loans to clients, interest earned on funds on deposit with a bank (investment income) etc

Revenue expenditure Expenditures on running costs such as rent, salaries or fuel

Short-term borrowing The outstanding amounts that an organization owes to a bank or other lender that are due within a year

Straight-line method This is the method of depreciation whereby an equal amount is deducted from the cost of the asset annually over its expected life

Transaction A business event that can be expressed in money and must be recorded in the accounting records These are evidenced by business (or source) documents such as invoices, receipts etc

Trial Balance This is a two-column schedule listing the names and balances of all the accounts in the ledger The debit balances are listed in the left-hand column and the credit balances in the right-hand column It is proof of equality of the debit and credit sides which should agree

5 6 RECOMMENDED FURTHER READING

Micro Start Version 1 A Guide for Planning, Starting and Managing a Micro Finance Programme UNDP Publication from the Private Sector Development Programme, New York, USA, 1997

Ledgerwood, Joanna and Kerri Moloney, Accounting Study Guide (Financial Management Training for Micro-Finance Organizations) Calmeadow (Investing in People) Toronto, Canada, 1996

Ledgerwood, Joanna, Finance Study Guide Calmeadow (Investing in People), Toronto, Canada 1996

Elliot, Nicola, Basic Accounting For Credit and Saving Schemes Oxfam (UK and Ireland), Oxford, England, 1996

Principles and Practices of Financial Management Women's World Banking, 1994

Please note that all are available in the Center for Microfinance Kampala library