FINANCIAL MANAGEMENT

Financial management deals with the procurement of funds and their effective utilization in order to achieve financial objectives of the business.

Objectives of financial management

1. To create wealth for the business
2. To generate cash for the business
3. To provide an adequate return on investment
4. To Satisfy stake holders
5. For growth

Importance of financial management

Finance is the life blood of the business organization, therefore each business must maintain adequate amount of finances for the business running and activities.

The importance includes;

1. Financial planning, financial management helps to determine the financial requirement of the business.
2. Acquisition offunds, this involves getting the required business funds by tapping the possible sources with least cost.
3. It ensures proper usage of funds, by spending the acquired funds on activities that increase the value of the firm`s asset.
4. It helps in making financial decisions in the business. Forexample the usage of funds, investment which may affect the entire business.
5. It’s used to increase profitability of the business, through ensuring proper budgeting and regular analysis of profits every time.
6. It helps management to assess the business performance, this is based on returns on investment, financial utilization etc.
7. It helps the business to compare performance of the business, by use of ratios analysis.

SOURCES OF FINANCES

The term finance is defined as the art and science of managing money.

Business finance is defined as the activity concerned with planning, raising, controlling and administering of the funds used in the business.

Sources include;

1. OWN SOURCE

   This includes personal income savings that one can use to start a business.

   Advantages

1. It allows an entrepreneur to make independent personal decisions on where to invest the fund and what to do with the profits realized.
2. It has no extra cost e.g. no interest is paid for the use of funds.
3. The entrepreneur has complete control over the benefits arising from the investment.
4. It is associated with self disciplinee.g. saving more and earn more
5. The source has no strings attached.

   Disadvantages

1. It takes long period of time to realize substantial amount of money.
2. It can promote extravagance since the entrepreneur has on external control.
3. It's difficult to distinguish personal income and business capital, this retard the growth of business.

2. SUPPLY CREDIT

This is where the supplier offers goods on credit and collects cash later after selling.

Advantages

1. It ensures that the business is constantly supplied with raw materials
2. It promotes good relation between the company and the business receiving credit.
3. The supplying company gets a lot of profits since goods sold on credit are always highly priced.
4. It helps those entrepreneurs without capital to start business.
5. It promotes self discipline since credit payment need hard work and honesty.
6. It increases market for supplying the company.

Disadvantages

1. It's associated with high cost of recovering credit.
2. It may lead to bad relationship since incase the credit is not cleared.
3. In case of demand fall, the suppliers register great losses.
4. It limits consumer choice
5. It increases the cost of doing business
6. It leads to buying goods of low quality goods or services. This makes buyer to make losses.

3. FAMILY SOURCE OF FINANCE

This include the use of family property,family savings used to start a business

Advantages

1. It has fewer strings attached
2. More amount of money is raised at once
3. It promotes accountability in the business.
4. The external supervision leads to efficiency in business operations.
5. Low cost of operation, since family members offer their expertise at almost no cost.
6. It mentors individual into the culture of saving and business operations.

Demerits

1. Family conflicts are extended to the business, this affect its growth
2. Sometimes personal interest may affect the business profit making
3. It may lead to bad relationship between the fund administer and the family members
4. Decision making and implementation is delayed and difficult as a number of family members are to be consulted.
5. It breads Conflict of leadership of the family property.

4. SELLING PART OF THE BUSINESS OR PERSONAL PROPERTY

This is where an entrepreneur converts some of the personal or business properties into cash to either get starting capital or expand the existing business.

Advantages

1. It has no strings attached.
2. Large amount of money is raised within a short period of time.
3. It leads to quick investment decision making.
4. It promotes hard work, in order to make profits and replace the sold property.
5. **RETAINED EARNINGS**

Some parts of profits which belong to ordinary share holders may not be paid out as dividends in the period they are earned. These profits are reinvested into the business or used to start a new business or expend or improve on the existing one.

6. **Commercial banks**

These provide finances in form of loans.Loan is the money borrowed from a financial institution like banks,cooperative credit societies, etc

Classification of loans

They can be short term or long term

The short term loan is the money borrowed with repayment period of less than one year. They include:

a) **Bank over draft**, this is where a customer with a current account is allowed to withdraw money over and above what is on his or her account.
b) **Soft loans,**this is the money that is advanced by commercial banks with fewer conditions and for a short period of time.
c) **Cash credit**, this is an arrangement by which a bank allows its customers to borrow money up to certain limit against the security pledged.

LONG TERM SOURCES

a) **Share capital,** this consists of ordinary share CapitaLand preference share capital
b) **Debenture or long term loans**, is defined as a written as a written acknowledgement of the debt incurred by a limited company.thi s takes about 20 and above years.
c) **Mortgages,** this raised by mortgaging assets
d) **Institutional investors,** these provide capital through the process of selling shares

Advantages of using a loan as a source of business capital

1. It provide extra capital to an entrepreneur, this is used to supplement on the available capital.
2. More money is raised in short period of time, this facilitate easy investment decision making.
3. It encourages hard work on the part of the borrower so as to repay the borrowed fund.
4. It facilitate easy planning, this is because large amount of money is raised in a single sum.
5. It’s accompanied by external monitoring from the lender; this improves the performance of the business.
6. It helps the entrepreneur to supplement on his or her savings.
7. Sometimes certain loans bear low interest rate, this leads to the growth of the business capital.

8. For the case of insured loans any change in business performance caused by natural factor, the entrepreneur assets is not affected.
9. A short term loan helps an entrepreneur to offsetshort-term deficit e.g paying workers,accessing raw materials etc.

Disadvantages

1. One can`t access it within the short period of time,acquiring it is a process. This delays investment decisions.
2. It is accompanied by external control; this affects the operation of the business.
3. Interest amount sometimes is high,this increases the business expenditures e.g. paying workers salaries on time is affected.
4. In case of business failure, the lending institution may take over ownership of the business.
5. Sometimes lending institutions take possession of the security pledged this affect the growth of business.
6. It affect the capital growth of the business, this is because the entrepreneur pay back more than the amount borrowed.

Procedure for borrowing

1. Developinga financial plan
2. Carrying out market survey on the lending institutions
3. Making an inquiry on the identified financial institutions
4. Obtaining lending terms and conditions of the different financial institutions.
5. Comparing the terms and conditions
6. Selecting the financial institution to deal with
7. Applying for a loan
8. Filling the application loan form
9. Assessing the applicant to establish whether the business is capable of paying back the loan.
10. Agree on the terms and conditions for investment and repayment of the loan.
11. Presenting the collateral security
12. Obtaining the loan
13. Start paying the loan

Circumstances under which an entrepreneur may go in for a loan

1. When he want to make an urgent profitable opportunity that require immediate funding.
2. When there is a financial gap to be filled
3. When the entrepreneur what to expand the business
4. In case the entrepreneur wants to meet the market demand.
5. In case the entrepreneur wants to supplement on the existing capital.
6. When there is need to increase on the working capital so as to serve the customer better.
7. When an entrepreneur is faced with short term financial crisis e.g. fall in demand resulting into a drop in the profit level.

LOAN MANAGEMENT

This refers to the various ways of how an entrepreneur is to effectively utilize the procured fund

profitably in order to make a profit and repay the funds at the sometime maintaining a good relationship with the lender.
The following ways are used

1. **Loan repayment schedule**

This is a table drawn by the lending institution or individuals showing the agreedmonthly installment amount are to be paid in terms of loan amount, interest amount.
It's drawn using two methods of interest calculations that is
Fixed method and reducing method

Example one

Mega enterprise borrowed shs 4,000,000 from Barclays Bank at an interest rate of 5% per month and it's paid in equal installment. Prepare aloan repayment schedule using a fixed method and reducing balance method.

Solution

DEMAKOKO MICRO FINANCE LTD
P. o. box 123 mbale
Loan repayment schedule
Name of the client: mega enterprises account no: 12224353
Loansize shs:4,000,000 .interestrate per month 5%
Loan period 5 years
Method of calculating interest: fixed installment method.

Period year	Principal installment Shs	Interest amount Shs	Total repayment shs	Principal balance Shs
1	800,000	2,400,000	3,200,000	3,200,000
2	800,000	2,400,000	3,200,000	2,400,000
3	800,000	2,400,000	3,200,000	1,600,000
4	800,000	2,400,000	3,200,000	800,000
5	800,000	2,400,000	3,200,000	Nil
Total	4,000,000	12,000,000	16,000,000	

Drafted by….. Approved by………………….
Name ………. Name………………………….
Title………. Title……………………………….

Note;

Interest is calculated as 5x12 =60% per year (60/100x4000, 000) =shs 2,400,000
Principal installment =4000, 000/5= shs800, 000 per year
Total repayment =interest amount +principal installment 800,000+2400, 000=shs3, 200,000

Reducing balance method

Demakoko micro finance ltd
P o box 123 mbale
Loan repayment schedule

Name of the client: mega enterprises account no: 12224353
Loan size: shs 4,000,000.Interest rate per month 5%Loan period: 5 years
Branch: mbale
Method of calculating interest: reducingbalancing method.

Period year	Principal installment Shs	Interest amount Shs	Total repayment Shs	Principal balance Shs
1	800,000	2,400,000	3,200,000	3,200,000
2	800,000	1,920,000	2,720,000	2,400,000
3	800,000	1,340,000	2,140,000	1,600,000
4	800,000	960,000	1,760,000	800,000
5	800,000	480,000	1,280,000	Nil
Total	**4,000,000**	**7,100,000**	**1,1,100,000**	

Drafted by….. Approved by……………………..
Name ……….. Name……………………………..
Title………. …… Title……………………………….

Note:

The interest is calculated basing on the outstanding principal loan balance for example in year one, 60/100x4, 000,000 =shs 2,400, 000, paid loan principal installment 800,000 and the balance being shs 3,200,000.

Year . 3, 200,000x60/100 =shs 1,920,000. Etc

2. Documenting every details of the loan
3. Informing the leading institution of any change in the business performance incase such changes may affect the sales.
4. Investing the loan in productive activities, such that the profits realized is used to pay the loan.
5. Ensuring proper management of the business, so as to make the business profitable to ease loan payment
6. Ensuring effective communication with the lender about issues related to loan management.
7. Attending workshops so as to be equipped with financial management information.

FINANCIAL NEEDS OF A POTENTIAL BUSINESS

The success of every business depends on proper identification of business needs. Like human beings have needs suchasfood security is the same case with business. The business needs include;

INVESTMENT NEEDS

These are need that an entrepreneur invests in order to get a return. These needs are either capital investment need or working capital needs. Capital investment needs include

- Acquisition of land
- Site preparation
- Buildings
- Machinery and equipment
- Installation of fixtures and fittings
- Furniture
- Provision for inflation

WORKING CAPITAL NEEDS

Thisrefers items needed to facilitate day to day activities of the business. These include;

- Purchase of raw materials
- Payments of labour
- Payment of utilities(water,power,telephone)
- Transport costs
- Packaging materials
- Payment of tax
- Machinery repairs
- Stationery and postage
- Payment of Interest on loans

PRE OPERATING NEEDS

These are business needs that the entrepreneur meets before commencement of business. They include;

- Business registration
- Trading license
- Market research
- Installation expenses
- Advertising
- Administrative costs
- Legal fees
- Supervision expenses
- Initial rent

BUSINESS BUDGET

A budget is a detailed statement which shows the estimated business revenue and estimated expenditure of the business for a given financial year. In finance, a financial plan is very critical in examining the financial implication of the business expenditures.

Importance of financial plan

Objectives of budgeting in business

1. To raise revenue for the business
2. To maintain competitive advantage of the business
3. To control expenditure of the business
4. To maintain quality of products in the business
5. To ensure effective utilization of the procured funds
6. To achieve efficiency in the business

Types of budgets

1. Fixed capital budget

P o 170 mbale

Fixed capital budget

Fixed capital requirements	**shs**
Acquisition	100,000
Purchase of machines tools	100,000
Construction of business premises	400,000
Purchase of furniture	500,000
Truck	200,000
Total	**1,300,000**

Pre operating budget

METHA HONEY MILLERS

P o box 120 mbale

Pre-operating budget

Requirements	**shs**
Business requisition	1,000,000
Trading license	1,000,000
Market research	1,000,000
Installations expenses	3,000,000
Advertising	1,000,000
Administrative costs	2,000,000
Initial rent	1,000,000
Total	**10,000,000**

2. **Working capital budget**

METHAT MEAT PROCESSOR

P. o.box120 mbale

Working capital budget

Requirement	shs
Purchase of materials	1000,000
Payment of labour	1000,000
Payment of utilities water power telephone	1000,000
Transport costs	1000,000
Packaging materials	1000,000
Payment of tax	1000,000
Total	**6000,000**

OTHER BUDGETS

Marketing budget

Production budget

Organizational budget

FINANCIAL STATEMENT ANALYSIS

A financial statement is an official document of an enterprise, which explores the entire financial information of the enterprise. Financial statement is an organized collection of data according to logical and consistent with accounting procedures. Its purpose is to convey an understanding of the financial aspects of the business.Hence a financial statement is the summary of the accounting process which provides useful information to both internal and external parties. Financial statements consist of the following;

1. Income statement or profit and loss account
2. Balance sheet or the position statement

INCOME STATEMENT

It's also called profit and loss account which reflects the operational position of the business during a particular period of time. Normally it consists of one accounting year. It determines the entire operational performance of the business like total revenue generated and expenses incurred for earning that revenue. Income statement helps to ascertain the gross profit and net profit of the business.

Gross profit is determined by preparation of trading account and net profit is determined by preparation of the profit and loss account.

ITEM RECORDED IN THE TRADING ACCOUNT AND NET PROFIT AND LOSS ACCOUNT

1. **Purchases,** this refers to the goods bought by an entrepreneur for resale.
2. **Opening stock**, (inventory) this refers to unsold goods available in the business at the beginning of a new financial year.

   NB.A business that has just commenced business does not have opening stock .hence its purchases becomes the opening stock.
3. **Closing stock**, this refers to the value of goods not sold by business at the end of the financial trading period. It'ssubtracted from the cost of goods available for sale
4. **Sales**, this refers to the value of goods which have been sold by a business. Or it's the revenue earned from the goods sold. The value is used to calculate the gross profit or loss.
5. **Sales returns or returns inwards**, these are goods previouslysold but have been brought back to the business.ie sales-returns inwards =net sales

   Reasons goods are sometimes returned
   - When goods are expired
   - When goods are wrong size
   - When goods have been damaged
   - When goods are of wrong color
6. **Purchases returns or return outwards**, these are goods previously bought by a business but have been sent back to the supplier. The value is subtracted from the purchases to get the net purchases that is

   Net purchases =purchases-purchase returns
7. **Gross profit**, this refers to the excess of net sales over the cost of goods sold. Or it's the total

profit obtained by an entrepreneur before paying off the operating and other expenses that is;

Gross profit = purchases –cost of goods sold

8. **Gross loss**, this refers to a situation where cost of sales exceeds the net sales.
9. **Trading or direct expenses,** these are expenses incurred by a business in order to get goods to the reach place and ready for sale such expenses are added to the purchases to get the total cost spent on goods bought. Trading expenses include;
   - Carriage inwards
   - Wages on purchases
   - Import duty on purchases
10. **Carriage,**this refers to the costincurred in transporting the goods into and out of the business. They are of two types;
    - **Carriage inwards**, this is the transportcost of bringing the goods bought up to the business. It forms part of the cost of goods bought and is added to the purchases in the trading account.
    - **Carriage out wards,** these are costs of transporting goods sold up to the buyer`s premises. Therefore they are added to the operating expenses
11. **Drawing of goods**, these are the physical items (goods) taken out of the business by the entrepreneur for private use. They are subtracted from the purchasesin the trading account, because such goods are recorded in the owners withdrawal account.

NB: its only drawings in form of goods that must be treated in the trading account

12. Salaries, this is payment usually mad to skilled labour at a fixed amount made after a fixed time interval
13. **Supplementary or miscellaneous income**, this is a term used to refer to other incomes or revenue that a business earns from other sources other than sales. They take the form of;
    - Rent income or rent received
    - Commission income
    - Interest received
    - Discount received
    - Bad debts recovered

All supplementary incomes are added to the gross profit in the profit and loss account to get the total income of the business.

Methods of preparation

There are two method used that is the T-format and the vertical method

However I have considered the vertical method in the following examples in this book

Example one

The following information was extracted from the books of fuga obulamu traders for the year ended 31 December 2016

Particulars	shs	closing stock	6,000 shs
Opening stock	15,000	rent	6,000

Purchases		180,000	insurance	2,000
Sales		250,000	advertisement	2,500
Returns inwards		5,000	wages and salaries	4,000
Returns outwards		4,000	stationery	5,000
Discount allowed	1,000			
Rent received		80,000		
Discount received	15000			

Required;

Prepare income statement for fuga obulamu traders for the year ended 31 December 2016.

solution

FUGA OBULAMU TRADERS` INCOME STATEMENT

For the year ended 31 December 2016

Particulars	Shs	Shs	Shs
Sales Less returns inwards **Net sales**			250,000 5,000

			245,000
		191,000	
		6,000	
			185,000
			60,000
		80,000	
		15,000	
			95,000
			155,000
		6,000	
		2,000	
		2,500	
		4,000	
		5,000	
		1,000	
			20,500
			134,500

EXAMPLE TWO

The following information was extracted from the books of HAM school canteen for the year ended 30 June 2017.

Purchases	400,000 shs
Sales	950,000
Discount allowed	5,000
Discount received	4,500
Rent	16,000
Rent received	55,000
Insurance	35,000
Carriage outwards	28,000
Electricity	25,000
Salaries	22,000
Bad debts	14,000
Office expenses	15,000
Carriage inwards	18,000

Returns inwards	5,000
Returns outwards	10,000
Opening stock	100,000
Closing stock	30,000

Required; prepare HAM canteen`s income statement for the year ended 30 June 2017

HAM CANTEEN`S

Income statement

For the year ended 30 June 2017

Particulars	Shs	shs	Shs
SALES			**950,000**
Less; returns inward			5,000
Net sales			945,000
Less:**COST OF SALES**			
Opening stock		100,000	
Add purchases	400,000		
Add carriage inwards	18,000		
Purchases before returns	418,000		
Less returns out wards	10,000		
Net purchases		408,000	
Goods available for sale		508,000	
Less closing stock		30,000	
Cost of sale			**478,000**
Gross profit			46,7000
Add other incomes			
Discount received		4,500	
Rent received		55,000	
GROSS INCOME			**526,500**
LESS: OPERATING EXPENSES;			
Discount allowed		5,000	
Rent		16,000	
Insurance		35,000	
Carriage outwards		28,000	
Electricity		25,000	
Salaries		22,000	
Bad debts		14,000	
Office expenses		15,000	
Total expenses			**160,000**
NET PROFIT			**366,500**

Example 3

The following was extracted from the books of jeniffer agro business ltd for the year ended 2017

Sales	40,000,000
Purchases	20,000,000
Purchases returns	1,620,000
Sales returns	500,000
Opening stock	10,000,000
Salaries and wages	3,000,000
Telephone	600,000
Closing stock	980,000

Required prepare Jennifer agro business ltd`s income statement for the year ended 31 December 2017

BALANCE SHEET

Balance sheet is a statement which showsthe financial position of the business at particulartime. It shows the money value of assets, liabilities and capital of the business on a given date. Henceit's used to understand the strength and weakness of the business. A balance sheet is prepared basing on an equation called the accounting equation or book keeping equation. This equation states that. Assets = liabilities **OR** assets = capital + liabilities,

C+L=A
A-L=C
A-C=L

Importance of a balance sheet

1. It's used in decision making and planning purposes
2. It shows the assets and liabilities of the firm
3. It is used to compare a firm`s financial performance with similar firms or previous periods
4. It's used to determine the financial position of the a firm at a particular date
5. It's used by creditors and bankers to decide the amount of credit and loans to extend to a firm.

ELEMENTS OF BALANCE SHEET

Assets these are the possessions of a business. Orthese are the possessions or properties owned by the business. They are grouped into two;

Fixed assets; these are the possessions or properties of the business which are of durable nature bought for use in the business for a longperiod of time. Examples include;

- Land
- Buildings
- Plant and machinery
- Vehicles
- Fittings and fixtures
- Furniture etc

Current assets, these are the possessions of the business which stay for a shorter period of time and are easily changed into cash. Common examples include;

- Cash
- Cash at bank
- Debtors
- Stock
- Raw materials
- Bills receivable
- Payments in advance. Or prepaid expenses
- Unused stationery
- Income due/ income not yet received.

LIABILITIES

These are debts or amount of money that the business owes to outsiders. Or they are claims of outsiders on the business. They are of two types;

Long term liabilities, these are debts or amount of money borrowed by the business that is to be repaid after a long period of time usually after year. Examples include;

- Bank loans of one year and above
- Debentures
- Mortgages

Current liabilities or short term liabilities, these are short debts of a business which are repaid within a short time usually less than one year.

Or these are claims by outsiders on the business that are repaid within one accounting period.

Examples include;

- Creditors
- Bank overdrafts
- Expenses due
- Bills payable

CAPITAL

This is the amount of money or resources invested in the business by the owner or an entrepreneur.

TYPES OF CAPITAL

Initial capital or capital invested, this refers to the actual amount of money or assts brought into the business by the entrepreneur.

Owner`s equity or net worth, this is the amount of resources in the business that belongs to the owner at a given date. Or

It's the amount of money that remains in the business after adding new investments and net profit or loss and subtracting drawings and any liabilities of the business. or

This is the difference between the business assets and liabilities of the business.

Capital owned = **initial capital + Net profit +additional investment – Drawings -loss**

Loan capital or borrowed capital, this is the total amount borrowed by the business inform of long term liabilities. That is;

- Borrowed capital =total long term liabilities

- Fixed capital, this refers to the value of fixed assets in the business.
- Fixed capital=total fixed assets.

Liquid capital, this refers to the value of current assets in form of cash, cash at bank and bills receivable. **Liquid capital =total current assets- closing stock**

Working capital, this is the excess of current assets over current liabilities of the business. Or Working capital is the difference between current assets and current liabilities. That is to say

- Working capital= asset--current liabilities.
- It'salso known as net current assets when the value of the current assts exceeds current liabilities

Capital employed, this is the total of the fixed assets plus the working capital. Or it's the sum of the owner`s equity and the long term liabilities of the business. That is

- Capital employed=fixed asset +working capital. Or
- Working capital=capital owned +long term liabilities
- Trading capital or gross capital employed=the total value of all the assets in the business. That is to say sum of fixed assets and current asset.

PREPARATION OF BALANCE SHEET

- It must have heading
- Items should be arranged in the category of assets, liabilities and capital
- Order of permanency
- Start with fixed assets and current assets and finally capital

Methods of preparation

There are two method used that is the T-format and the vertical method

However I have considered the vertical method in the following examples in this book

Example

The following information was extracted from the books NORAKI rice business at the end of the year ended 31 December 2016

Capital	10,000	stock	4,500
Machinery	3,500	bank overdrafts	800
Building	4,000	bank	500
Motor vehicle	1,500	debtors	3,500
Furniture	2,500		
2year loan	7,000		
Creditors	2,200		

Required: prepare NORAKI`S balance sheet as at 31 December 2016

Solution

NORAKI RICE BUSINESS`S

BALANCE SHEET

AS AT 31 DECEMBER 2016

PARTICULARS	SHS	SHS	SHS

FIXED ASSETS			
Machinery		3,500	
Buildings		4,000	
Motor vehicle		1,500	
Furniture		2,500	11,500
CURRENT ASSETS			
Debtors	3,500		
Bank	500		
Stock	4,500	8,500	
LESS: CURRENT LIABILITIES			
Creditors	2,200		
Bank overdraft	800	3,000	
Working capital			5,500
CAPITAL EMPLOYED			**17,000**
Financed by;			
Capital			10,000
Add 2yeae loan			7,000
			17,000

EXERCISE

The following information was extracted from books of Kamalu enterprise for the month of August.

The following information was obtained from the books of Hope enterprises on 31- 3-14

	Shs
Land and buildings	4,000,000
Furniture	540,000
Juice processor (machine)	900,000
Motor vehicle	180,000
Mortgage loan	2,000,000
Debenture	400,000
3 years loan	500,000
Capital	2900,000
Net profit	300,000
Commission income prepaid	65,000
Stock in trade	3,000,000
Bank balance	28,000
Cash in hand	440,000
Prepaid expenses	3,000
Creditors	81,000
Interest on land due	145,000

Required

a. Prepare a balance sheet on that date
b. Calculate the following types of capital

i. Fixed capital
ii. Working capital
iii. Capital employed
iv. Borrowed capital
v. Net worth

EXERCISE

Below are the financial transactions of Busiro traders as at 31st Dec 2017

Capital	1,810,000
Motor van	1,500,000
Closing stock	460,000
Bank loan	1,550,000
Bank balance	108,000
Debentures	1,200,000
Fixtures	1,400,000
Building	1,490,000
Creditors	1,360,000
Bank over draft	1,400,000
Debtors	1223,000
Cash balance	108,000

The following information was also compiled

Opening stock as at 1st January 2013	1,732,000
Purchase for the year	1,820,000
Return outwards	1,082,000

Using the above information, you are required to calculate

i. Fixed capital
ii. Borrowed capital
iii. Cost of sales
iv. Average stock
v. Rate of stock turn
vi. Working capital
vii. Capital employed

PREPARING FINAL ACCOUNTS (INCOME STATEMENT) FROM A GIVEN TRIAL BALANCE

From a given trial balance the income statement and the balance sheet can be prepared using information from the same source.

A trial balance is table that shows a list of item balances as per their ledgers at a given date. The total of debt balances is always equal to total balances of the credit.

Reasons for preparing a trail balance

1. It is prepared to check the arithmetic accuracy recording of the business transactions in the books of accounts.(ledger and cash book)
2. To show the value of various assets,liabilities,expenses and revenue items of the business at a particular date.
3. To provide information for the preparation of the final accounts and balance sheet
4. To test whether the ledger account balances have been correctly posted to the collect columns of the trail balance

A trail balance is prepared as a step towards final accounts.

Structure of trail balance

Details	Folio	Debt (shs)	Credit (shs)

Accounts and their balances brought down

Capital	(Cr)
Assets	(Dr)
Liabilities	(Cr)
Expenses/ losses	(Dr)
Income/gains	(Cr)

The following information was extracted from mukko enterprises on 28.2.2017

Purchases	37,600
Sales	65,800
Cash at bank	3,800
Cash in hand	700
Capital	33,000
Drawings	9,500
Office furniture	7,800
Rent rates	3,400
Wages and salaries	8,600
Discounts allowed	2,300
Discounts received	1,200
Debtors	16,400
Creditors	8,300
Stock (opening stock)	6,900
Commission received	900
Delivery van	8,000
Bad debts written off	2,700
Van running costs	1,500

Required

Prepare .trail balance for mukko enterprises for the year ended 28 February 2017

prepare income statement for mukko enterprises for the year ended 28 February 2017 and balance sheet as at 28 February 2017

Example 3

The following information trial balance was extracted from the books of JAK stationery shop as at 28 February 2017.

Details	Dr	Cr
Sale		128,000
Purchases	90,000	
Returns	6,000	5,000
Carriage inwards	10,000	
Opening stock	28,000	
Rent	4,000	
Advertising	8,000	
Premises	122,000	
Machinery	75,000	
Debtors	18,000	
Creditors		31,000
Bank loan		60,000
Cash at hand	14,000	
Cash at bank	27,000	
Drawing	10,000	
Discount allowed	5,000	
Discount received		6,000
Commission receivable		20,000
Capital		190,000
Carriage outwards	8,000	
Wages and salaries	15,000	
	440,000	440,000

Required: prepare income statement for JAKstationery shop for the year ended 28 feb 2017
And balance sheet as at 28 February 207

JAK STATIONERY SHOP`S

Income statement

For the year ended 28 February 2017

Particulars	Shs	Shs	Shs
Sale		128,000	
Less: sales return			122,000

		6,000	
		28,000	
		95,000	
		123,000 48,000	
			47,000
		6,000 20,000	26,000 73,000
		4,000 8,000 5,000 8,000 15,000	40,000
			33,000

JAK STATIONERY SHOP`S

Balance sheet

As at 28 February 2017

DETAILS	SHS	SHS	SHS

FIXED			
Premises		122,000	
Machinery		75,000	197,000
Current assets			
Stock	48,000		
Debtors	18,000		
Cash at bank	27,000		
Cash in hands	14,000	107,000	
Less: **current liabilities**			
Creditors		31,000	
Working capital			76,000
CAPITAL EMPLOYED			**273,000**
FINANCED BY			
Capital		190,000	
Add::net profit		33,000	
Less: drawings		10,000	227,000
Add :Bank loan			60,000
NET CAPITAL EMPLOYED			**273,000**

The following relates to the trial balance extracted from salt traders for the year ended 31 December 2015.

Particulars	Dr shs	Cr shs
Cash in hand	42,000	
Cash at bank	80,000	
Stock 1.1.2015	100,000	
Creditors		100,000
Returns inwards	15,000	
Sales		560,000
Purchases	315,000	
Salaries	40,000	
Water bills	6,000	
Postage	2,000	
Drawings	89,000	
Return outwards		10,000
Furniture	750,000	
Motor van	350,000	
Loan		300,000
Rent income		12,000
Carriage inwards	7,000	
Carriage outward	10,000	
Capital		824,000
Closing stock	13,500	

	1,806,000	**1,806,000**

SALT TRADERS`

INCOME STATEMENT

For the year ended 31 December 2015.

PARTICULARS	SHS	SHS	SHS
Sales			560,000
Less: returns inwards			15,000
Net sales			545,000
Less cost of sales			
Opening stock		100,000	
Add: purchases	315,000		
Add :carriage inwards	7,000		
Purchases before returns	322,000		
Less :returns outward	10,000		
Net purchases		312,000	
Goods available for sale		412,000	
Less closing stock		13,500	
COST OF SALE			398,500
Gross profit			146,500
Add: rent income			12,000
Gross income			158,500
LESS OPERATING COSTS			
Salaries		40,000	
Water bills		6,000	
Postage		2,000	
Carriage outwards		10,000	
Total expenses			58,000
NET PROFITS			100,500

SALT TRADERS`

Balance sheet

As at 31 December 2015

Details	shs	Shs	shs
ASSETS			
Fixed assets			
Furniture		750,000	
Motor van		350,000	1,100,000
Current assets			
Cash in hands	42,000		
Cash at bank	80,000		
Closing stock	13,500	135,500	
LESS: CURRENT LIABILITIES			
Creditors		100,000	
Working capital			35,500
CAPITAL EMPLOYED			**1,135,500**
FINANCED BY:			
Capital		824,000	
Add: net profit			
Capital before drawings			924,500
Less: drawings			89,000
Capital worth			835,500
Add long term liabilities			300,000
NET WORTH			**1,135,500**

YEAR –END ADJUSTMETS

At the end of the financial year, some expenses over lap the period such expenses must be considered when the final accounts are prepared at the end of the period. Such expenses include

ACCRUALS,

These are expenses that remain unpaid at the end of the period. These expenses may also called outstanding expensesor expenses owing or expenses due.

Treatment of such expenses

In the income statement, they are added to the expenses actually paid. In the balance sheet, they appear as current liabilities.

Examples include

- Rent unpaid
- Outstanding wages and salaries
- Outstanding electricity and water bills etc

PAYMENT IN ADVANCE OR PREPAYMENT EXPENSES

These are expenses paid in advance that is to say expenses paid beyond the period under review e.g. rent paid in advance, ratesinsurance paid in advance. These payments are made before the benefits are enjoyed

Treatment

In the income statement such expenses are deducted from the period`s expenses andin the balance sheet such expenses are treated as current assets

INCOMES

Like expenses, incomes may be received before working for it (income in advance)and sometimes such income may not be received as expected and therefore described as outstanding income.

Treatment

Income received in advance,

Such income is subtracted from the incomes for the period in the income statement and in the balance sheet; such income is treated as current liabilities.

Incomes outstanding

Incomes outstanding are added to incomes actually received for the period. In the balance sheet it's treated as current asset

Income earned but not yet received,

It's possible that interest on bank deposit may be due but not yet credited or tenants have delayed payments, such incomes are treated as current assets and shown in the balance sheet

Example 4

The following information was extracted from the books of Kampala coaches for the period ended 30 June 2017

	SHS
Capital	1540,000
Sales	25,000,000
Purchases	16,000,000
Drawings	30,000
Rent	870,000
Opening stock	420,000
Returns inwards	40,000
Returns outwards	30,000
Debtors	3,420,000
Creditors	270,000
Cash at bank	630,000
Furniture	570,000
Transport	220,000
Advertising	590,000

Additional information:

Closing stock was valued at shs 3,500,000

Rent accrued shs 30,000

Transport worth shs 20,000 was paid in advance

Required;

Prepare Kampala coaches` income statement for the period ended 30 June 2017 and balance sheet as at 30 June 2017

KAMPALA COACHES`

Income statement

For the period ended 30 June 2017

PARTICULARS	SHS	SHS	SHS
Sales		25,000,000	

Less sales returns		40,000	
Net sales			**24,960,000**
Less cost of goods sold:			
Opening stock		420,000	
Add purchases	16,000,000		
Less returns outwards	30,000		
Net purchases		**1,5970,000**	
Goods available		16,390,000	
Less closing stock		**3,500,000**	
Cost of goods sold			12,890,000
Gross profit			**12,070,000**
LESS OPERATING EXPENSES:			
Rent	870,000		
Add accrued rent	30,000	900,000	
Transport	220,000		
Less transport paid in advance	20,000	200,000	
Advertising		590,000	
Total operation expenses			1,690,000
NET PROFIT			**10,380,000**

KAMPALA COACHES`
Balance sheet
As at 30 June 2017

PARTICULARS	SHS	SHS	SHS

ASSETS			
Fixed asset			
furniture		570,000	
buildings		6,480,000	7,050,000
CURRENT ASSET			
Debtors	3,420,000		
Cash at bank	630,000		
Closing stock	3,500,000		
Transport paid in advance	20,000	7,570,000	
LESS: CURRENT LIABILITIES			
Creditors	2,700,000		
Rent accrued	30,000	2,730,000	
Working capital			4,840,000
CAPITAL EMPLOYED			**11,890,000**
FINANCED BY:			
Capital		1,540,000	
Add net profit			
Capital before drawings			30,000
Less drawings			**11,890,000**
Net equity			

EXAMPLE 5

The following information relates to kunya traders` trial balance for the end of the 31 December 2017

PARTICURS	DR (shs)	CR (SHS)
Capital		40,000
Purchases	81,500	
Stock 1 Jan 2015	5,200	
Wages	6,165	
Sales		108,850
Creditors		15,100
Salaries	3,780	
Debtors	6,750	
Motor van	18,000	
Cash at Bank	6,735	
Electricity	890	
Rates	2,250	
Buildings	38,000	
Discount received		1,050
Discount allowed	610	
Rent income		3,200
Commission income		1,800
Cash in hands	120	
	170,000	**170,000**

Additional information

a) Closing stock was valued at shs 5460
b) Wages and salaries outstanding was shs 490 and 640 respectively
c) Rates have been paid for 15 month up to 31 March 2018
d) Commission due from client was shs 300 for the job already done
e) Rent of shs 200 was received in advance.

Required: prepare kunya traders` income statement for the year ended 31 December 2017
And balance sheet as at 31 December 2017

KUNYA TRADERS`
Income statement
For the year ended 31 December 2017

PARTICULARS	**SHS**	**SHS**	**SHS**
Sales			108,850
Less cost of goods sold:			
Opening stock		5,200	
Add purchases	81,500		
Add wages	6,165		
Add wages due	490		
Net purchases		88,155	
Goods available for sale		93,355	
Less :closing stock		5,460	
Cost of goods sold			87,895
Gross profit			**20,955**
Add other incomes			
Commission income	1,800		
Add commission due	300	2,100	
Rent income	3,200	3,000	
Less: rent received in advance	200	1,050	
Discount received			6,150
Gross income			**27,105**
Less: operating expenses:	3,780		
Salaries	640	4,420	
Add salaries due		890	
Electricity	2,250		
Rate	450		
Less prepaid		1,800	
Discount allowed		610	
Total expenses			
NET PROFIT			**19,385**

KUNYA TRADERS`

Balance sheet
As at 31 December 2017

PARTICULARS	SHS	SHS	SHS
ASSETS			
FIXED ASSETS			
Buildings		38,000	
Motor van		18,000	56,000
CURRENT ASSET			
Stock	5,460		
Debtor	6,750		
Rates paid in advance	450		
Commission due	300		
Cash at Bank	6,735		
Cash in hand	120	19,815	
LESS: CURRENT LIABILITIES			
Creditors	15,100		
Outstanding wages	490		
Outstanding salaries	640		
Rent received in advance	200	16,430	
Working capital			3,385
CAPITAL EMPLOYED			**59,385**
FINANCED BY:			
Capital			40,000
Add net profit			19,385
Net equity			**59,385**

RESERVES AND PROVISIONS

In any business, it's necessary that some profits be put aside to cater for unforeseen events that may affect capital and planning for the business

Therefore reserves are made for depreciation of capital assets of the business. At the same time it'sa rare case that all goods are sold on cash some are sold on credit which is also difficult to make all creditors settle their obligations and therefore provisions are made for those who may fail to meet their payment obligations

PROVISION FOR BAD DEBTS OR DOUBTFUL DEBTS AND DEPRECIATION

A provision is an amount of money put aside for a probable loss which cannot be calculated .the amount to be set aside depends on the past experience of the entrepreneur. Hence a provision may be increased or decreased

All provisions affect debtor`s amount

For the case of decrease in provision the amount is added to the gross profit of the business.

PROVISION FOR DEPRECIATIONS

Depreciation refers to the totalloss in value of fixed assets

Causes

Being out of date (obsolescence)that is assets loss value due to change in fashion
Exhaustion
Physicaldeterioration due to wear and tear

Calculation of depreciation

Reducing method
Straight line method

EXAMPLE 6

The following trial Balance was extracted from the books of Kumi traders association on 31 December 2016

	DR SHS	CR SHS
Capital		40,000,000
Purchases	26,154,000	
Sales		36,246,000
Salaries	4,814,000	
Opening stock	4,307,000	
Insurance	820,000	
Rent income		965,000
Buildings	25,000,000	
Furniture	14,500,000	
Debtors	6,140,000	
Other expenses	1,060,000	
Creditors		4,638,000
Commission received		946,000
	8, 2795,000	**8, 2795,000**

ADDITIONAL INFORMATION

a) Salaries due shs 350,000
b) Insurance was paid for 15 months
c) Rent received in advance was shs 165,000
d) Commission accrued but not yet received was shs 120,000
e) Furniture to be depreciated by 10%
f) Provide 5% for debtors are doubtful
g) Stock on 31 December 2016 was valued at shs 5008,000

Required: prepare income statement for kumi trader`s association for the year ended 31 December 2016 and Balance sheet as at 31 December 2016

KUMI TRADERS` ASSOCIATION`S

Income statement

For the year ended 31 December 2016

PARTICULARS	SHS	SHS	SHS
Sales			56,246,000
LESS COST OF SALES			
Opening stock		4,307,000	

Add purchases		26,154,000	
Goods available for sale		30,461,000	
Less closing stock		5,008,000	
Cost of sales			**25,453,000**
Add other incomes			
Rent received	965,000		
Less rent received in advance	165,000	800,000	
Commission received	946,000		
Add accrued commission	120,000	1,066,000	1,866,000
Gross income			**12,659,000**
LESS OPERATING EXPENSES			
Salaries	4,814,000		
Add accrued salaries	350,000	5,164,000	
Insurance	820,000		
Lee prepaid insurance	205,000	615,000	
Other expenses		1,060,000	
Bad debts		307,000	
Depreciation on furniture		1,450,000	
Total operating expenses			8,596,000
NET PROFIT			**4063,000**

KUMI TRADERS` ASSOCIATION`S

Balance sheet

Asat 31 December 2016

Particulars	Shs	shs	Shs
Fixed asset			
Building		25,000,000	

Furniture	14,500,000		
Less provision for depreciation	1,450,000	13,050,000	38,050,000
Current assets			
Stock		5,008,000	
Debtors	6,140,000		
Less provision for bad debts	307,000	5,833,000	
Prepaid insurance		205,000	
Accrued commission		120,000	
Total		11,166,000	
Less current liabilities			
Creditors	4,638,000		
Salaries due	350,000		
Rent received in advance	165,000	5,153,000	
Working capital			6,013,000
Capital employed			44,063,000
Financed by			
Capital			40,000,000
Add net profit			4,063,000
Capital employed			**44,063,000**

Example 7

The following information relates to the trial Balanceof mbale hospital canteen for the year ended 31 December 2017

Opening stock	1,046,050	
Capital		12,500,000
Sales		4,352,100
Returns 11,250	28,700	
Purchases	2,070,850	
Plant and machinery at cost	3,500,000	
Office furniture at cost	1,575,000	
Freehold property at cost	6,577,900	
Provisionfor bad debts		31,400
Motor van at cost	362,000	
Shop fittings	64,300	
General expenses	18, 7250	
Insurance	225,000	
Postage and telephone	18,500	
Power and light	189.100	
Stationery and printing	29,100	
Rates	176,200	
Bad debts	25,750	
Wages and salaries	503,750	
Carriage outwards	222,100	

Debtors	642,500	
Creditors		276,000
Drawings	200,000	
Bank	503,200	
Carriage inwards	175,000	
Cash	98,600	
Discount received		21,200
Provision for depreciation		
Plant and machinery		1,161,000
Office furniture		33,000

Additional information

a) Closing stock was valued at shs 975,200
b) The proprietor took goods worth shs 105,000
c) Postage and telephone outstanding was shs 37,500
d) Wages outstanding shs96, 250
e) Rates of shs 120,000 were paid in advance
f) Provision for bad debts is to adjusted to 8% of debtors
g) Provide forPlant and machinery at15%on the book value
h) Office furniture at 10% on cost
i) Motor van at 20% on cost
j) Shop and fittings at 5% on cost

Required

Prepare income statement for mbale hospital canteen for the year ended 31 December 2017 and Balance as at 31 December 2017

MBALE HOSPITAL CANTEEN`S

Income statement

For the year ended 31 December 2017

PARTICULARS	**SHS**	**SHS**	**SHS**
Sales			4,352,100
Less :sales returns			11,250
NET SALES			**4,340,850**
LESS COST OF SALES			
Opening stock		1,046,050	
Add: purchases	2,070,850		
carriage inwards	17,500		
Purchases before returns	2245,850		
Less:returns out wards	28,700		

Purchases before drawings	2,217,150		
Less: drawings	105,000		
Net purchases		2,112,150	
Goods available for sale		**3,158,200**	
Less closing stock		975,200	
Cost of sales			**2,183,000**
Gross profit			2,157,800
Add discount received			21,200
Gross income			**21,759,000**
LESS OPERATING EXPENSES			
Insurance		225,000	
General expenses		187,250	
Postage and telephone	18,500		
Add outstanding postage and telephone	37,500	**56,000**	
Power and lighting		189,100	
Stationery		29,100	
Rates	176,200		
Less rates paid in advance	120,000	**56,200**	
Bad debts		25,750	
Wages and salaries	503,750		
Add outstanding wages and salaries	96,250	**600,000**	
Carriage out wards		222,100	
Provision for bad debts		20,000	
Depreciation			
Plant and machinery	350,850		
Office furniture Shop fittings Motor van **Total expenses** NET LOSS	15,750 3,215 72,400	 583,965	 2,194,465 **15,465**

MBALE HOSPITAL CANTEEN`S
Balance sheet
Asat 31 December 2017

Particulars	Shs	shs	Shs
FIXED ASSETS			
Plant and machinery	3,500,000		
Less provision for depreciation	1,511,850	**1,988,150**	
Office furniture	157,5000		
Less provision for depreciation	190,500	**1,384,500**	
Freehold property		6,577,900	
Motor van	362,000		
Depreciation	72,400	**289,600**	

Shop fittings	64,300		
Less :depreciation	3,215	**61,085**	**10,301,235**
CURRENT ASSETS			
Stock		975,200	
Debtors	642,500		
Less: provision for bad debts	51,400	**591,100**	
Cash at Bank		503,200	
Cash in hands		98,600	
Rtes paid in advance		120,000	
Total		2,288,100	
LESS: CURRENT LIABILITIES			
Creditors	276,050		
Outstanding postage and telephone	37,500		
Outstanding wages and salaries	96,250	**409,800**	
Working capital			1,878,300
Capital employed			**12,179,535**
FINANCED BY:			
Capital			12,500,000
Add net loss			15,465
Capital employed before drawings			**12,484,535**
Less drawings			305,000
CAPITAL EMPLOYED			**12,179,535**

EXAMPLE 8

The following trail balance relates to the books of apuuli enterprises ltd for the trading year ended 31 December 2016

Purchases shs 37,600,000
Sales 65,800,000
Returns inwards 45,000
Returns out wards 38,000
Cash at hand 30,800,000
Cash at bank 700,000
Capital 689,707,000
Drawings 90,500,000
Office furniture 480,000,000
Rent and rates 3,400,000

Salaries	8,600, 000
Discount allowed	2,300, 000
Discount received	1,200, 000
Debtors	16,400, 000
Creditors	8,300, 000
Wages	1,500,000
Stock on 1 Jan 2016	9,900,000
Provision for bad debts	900, 000
Delivery van	80,000,000
Van expenses	1,500, 000
Bad debts	2,700,000

Additional information

a) Closing stock was shs 11700,000
b) Of rates shs 400,000 relates to Jan 2017and of rent shs 500,000 was out standing
c) Bad debts written off at the end of the year was shs 300,000
d) Provision for bad debts to be adjusted to 10% of debtors
e) Required
f) Prepare income statement for apuuli traders' ltd for the year ended 31 December 2016
g) And Balance sheet as at 31 December 2016

Example 9

The following information relates to the obama events management business 31 Dec 2017

	shs
Sales	10,500,000
Purchases	5,400,000
Drawings	1,250,000
Debtors	2,100,000
Creditors	1,420,000
Stock	3,500,000
Motor van	820,000
Equipment	1,945,000
Carriage inwards	340,000
Returns inwards	235,000
Returns out wards	170,000
Rent and rates	543,000
Carriage out wards	168,000
Telephone	1,810,000
Office expenses	920,000
Salaries and wages	146,000
Insurance	690,000
Postage	190,000
Motor expenses	200,000
Sundary expenses	306,000
Capital	17,567,000
Electricity	400,000

ADDITIONAL INFORMATION

a) Stock at close was shs 3,230,000
b) Rent prepaid 45,000
c) Postage in arrears 20,000
d) Depreciate motor van by 5% per annum
e) Insurance of shs 45000 owing (outstanding)

Required

Prepare an income statement for obama events management for the year ended 31 Dec 2017and Balance sheet as at that date

BOOKKEEPING

By definition, bookkeeping is the process of recording business or a company's financial transactions the accounting process involves classifying, reporting and analyzing of data and none of it can take place if there is no organized and accurate bookkeeping.

1. **Better financial analysis and management,** Bookkeeping can systematize it up from up-to-date follow-ups, invoicing and on-time payment for suppliers for analysis.
2. **Fulfillment of Tax Obligations, Bookkeeping** keeps track on any information and documents in order to accomplish annual tax. Tax returns are also made easier with an organized Balance Sheet, Cash Flow and Profit & Loss,
3. **Reporting to Investors is Easy,** From charts, graphs to lists of data presented to the investors are all acquired from the book of account.
4. **It makes Business Planning easy, by** the help of Balance Sheet and Profit & Loss is used to check if the company is on the right track financially.
5. **Proper Record Keeping** makes retrieving process easy once audit time comes
6. **Cash Flow –** Keeping track of cash flow is critically important for any business and it's only possible when a business have accurate financial records.
7. **Expenses –** Sole traders can claim specific expenses which have been wholly and exclusively incurred as part of their business. This ensures that the person doing the bookkeeping has an understanding of outgoing and monitors them for tax and accounting purposes.
8. **Profitability and Growth,** Accurate bookkeeping allows an entrepreneur to see whether or not the business is actually making a profit and appropriate measures are taken to improve on the business.
9. Acts as a tool for controlling assets in the business so as to eliminate the possibility of theft, fraud, pilferage, embezzlement.

TECHNIQUES OF FINANCIAL STATEMENT ANALYSIS

Financial statement analysis is interpreted to determine the financial and operational performance of the business. A Number of methods or techniques are used to analyze the financial statement of the business. The following are the common methods or techniques which are widely used by the business enterprises

1. Ratio analysis
2. Cash flow statement
3. Funds flow
4. Trend analysis
5. Comparative statement analysis

FINANCIAL RATIOS

Definition

Financial ratios are mathematical comparisons of financial statement accounts or categories. These relationships between the financial statement accounts help investors, creditors, and internal company management understand how well a business is performing and of areas needing improvement. Or

A financial ratio is a mathematical comparison between two or more items from business`s balance sheet or income statement. These are used to measure the progress of the business, uncover trends, and point to potential problem areas. Bankers and investors often analyze these numbers to decide whether to lend you money or invest in your company.

Financial ratios are the most common and widespread tools used to analyze a business' financial standing. They are also used to compare different companies in different industries. Since a ratio is simply a mathematically comparison based on proportions, big and small companies can use ratios to compare their financial information, to identify their strengths and weaknesses

IMPORTANCE OF FINANCIAL RATIOS

1. They are useful indicators of a company's ability to manage short-term obligations as they provide important information about business strength. E.g. liquidity ratio
2. They help to measure the efficiency of a business i.e. how well it uses its assets. E.g. Leverage ratios which indicate the long-term financial strength of a business.
3. They are used to determine the Profitability of the business, by comparing profits to assets or equity.
4. Ratios help in analyzing the performance trends over a long period of time of the business.
5. They also help a business to compare the financial results to those of competitors.
6. Ratios assist the management in decision making regarding investment.
7. Financial ratios are used to assess the financial performance and determine the financial position of an enterprise e.g. through its profitability, liquidity, activity, leverage and other relevant indicators.
8. They help management to prepare budgets, to formulate policy, and to prepare the future plan of action.

USERS OF FINANCIAL RATIOS

1. **Bankers and Lenders:** Use profitability, liquidity and investment because they want to know the ability of the borrowing business in regular scheduled interest payments and repayments of principal loan amount.
2. **Investors:** Use profitability and investment because they are more interested in profitability performance of business and safety & security of their investment and growth potential of their investment.
3. **Government:** Use profitability because government may use profit as a basis for taxation, grants and subsidies.
4. **Employees:** Use profitability, liquidity and activity because employees will be concerned with job security, bonus and continuance of business and wage bargaining.
5. **Customers:** Use liquidity because customers will seek reassurance that the business can survive in the short term and continue to supply.

6. **Suppliers:** Use liquidity because suppliers are more interested in knowing the ability of the business to settle its short-term obligations as and when they are due.
7. **Management:** Use all ratios because management is interested in all aspects i.e., both financial performance and financial condition of the business.

TYPES OF RATIOS

. Financial ratios are often divided up into seven main categories:
Liquidity
Profitability
Solvency
Efficiency
Market prospect
Investment leverage
Coverage

LIQUIDITY RATIO

1. Current ratio

Current Ratio =

NB. It evaluates the ability of a business to pay short-term obligations using current assets

2. Acid Test Ratio =

Or

Also known as "*quick ratio*", it measures the ability of a company to pay short-term obligations using the more liquid types of current assets or "quick assets" (cash, marketable securities, and current receivables).
It Measures the ability of a business to pay its current liabilities using cash and marketable securities. Marketable securities are short-term debt instruments that are as good as cash. In many businesses a significant proportion of current assets may comprise of inventory. Inventory, by nature, cannot be converted into ready cash abruptly. The term liquid assets does not include inventory.
Hence *the term liquid or quick asset includes all the current assets minus inventory at prepaid expenses*

3. Net Working Capital = Current Assets - Current Liabilities

Determines if a company can meet its current obligations with its current assets; and how much excess or deficiency there is.

Example one

	Shs
Equity share capital	2,00,000
	90,000

General reserve	
Sundry creditors	60,000
Bills payable	20,000
Bank overdraft	30,000
Provision for tax	5,000
Proposed dividend	10,000
Outstanding salaries	5,000
Long term loans	60,000
Land & building	80,000
Machinery	1,20,000
Cash	10,000
Bank	30,000
Stock	1,40,000
Short-term investments	25,000
Sundry debtors	
Less provision	36,000
Bills receivable	10,000
Prepaid insurance	9,000
Preliminary expenses	20,000

Determine current ratio and quick asset ratio

Solution

Current ratio =

But Current assets are cash, bank, stock, investments, sundry debtors (net), bills receivable and prepaid insurance.= shs10,000+30,000 + 1,40,000 + 25,000 + 36,000 + 10,000 + 9,000 = shs2,60,000.

Current liabilities are sundry creditors, bills payable, bank overdraft, and provision for tax, proposed dividend and outstanding salaries

= 60,000 + 20; 000 + 30,000 + 5,000 + 10,000 + 5,000

= shs1, 30,000

Current ratio = 2, 60,000/1, 30,000

= 2: 1

Quick ratio =

Quick assets = Current assets - (Stock + Prepaid expenses)

= 2, 60,000-(1, 40,000+ 9,000)

= shs 1, 11,000

Quick ratio = 1, 11,000 / 1, 30,000

= 0.85: 1

4. Interest Coverage: This ratio is calculated by dividing Profits before Interest and Taxes by total Interest Expense.
5. Asset to sales: This ratio is calculated by dividing Assets by Sales.
6. Dividend Payout. This ratio is calculated by dividing Dividends by Net Profit.

7. Current Debt/Total Assets. This ratio is calculated by dividing Current Liabilities by Total Assets.

PROFITABILITY RATIOS

This is the measure of the ability of the business to generate sufficient revenue to finance its under taking. The ratios include

1. **Gross profit ratio**

Gross profit ratio is the ratio of gross profit to net sales i.e. sales less sales returns. The ratio thus reflects the margin of profit that a business is able to earn on its trading and manufacturing activity. It is the most commonly calculated ratio. It is employed for inter-firm comparison of trading results. It's given by:

Gross profit ratio= 100

Example:

Calculate gross profit ratio (GP Ratio) from the following particulars.

Particulars	**Shs**	**Particulars**	**Shs**
Sales	1,55,000	Purchases	80,000
Sales returns	5,000	Purchases returns	10,000
Opening stock	40,000	Closing stock	10,000

Solution:

Cost of goods sold = Opening stock + Net purchases - Closing stock

= 40,000 + 70,000 - 10,000

= 1, 00,000

Net sales = 1, 55,000 - 5,000

= 150,000

Gross profit = 1, 50,000 - 1, 00,000

= 50,000

Gross profit ratio = (50,000 / 1, 50,000) x 100

= 33.33 %

Or markup is the gross profit expressed as a percentage of the cost of sale

I.e. markup =gross profit/cost of sales x100

2. ***Net profit ratio (NP ratio)*** expresses the relationship between net profit after taxes and sales. This ratio is a measure of the overall profitability of the business. The ratio indicates what portion of the net sales is left for the owners after all expenses have

Net profit ratio = **x100**

Example:

From the following information calculate net profit ratio (NP ratio)

Total sales shs 520,000;

Sales returns shs 20,000;

Net profit shs 40,000

Net sales = (520,000 – 20,000) = 500,000

Net Profit Ratio = [(40,000 / 500,000) × 100]

= 8%

3. **Return on investment =x100**

Or **x100**

Profit to asset turn over = x100
Or
Profit to asset turn over =

EFFICIENCY RATIOS
These ratios measure the level of efficiency of business activities. Theyindicate the number of times an asset is turned into sales. They include

1. **Inventory Turnover =**

Represents the number of times inventory is sold and replaced. A high ratio indicates that the business is efficient in managing its inventories.

2. **Days Inventory Outstanding** =

   Inventory outstanding is also known as *"inventory turnover in days"*. It represents the number of days inventory sits in the business. In other words, it measures the number of days from purchase of inventory to the sale of the same,the shorter the days the better.

3. **Stock turn over period**

   This ratio measures the average number of days stock is held before being sold off in a given period of time

   Stock turn over = **x365 days**

4. **Debtors` turn over,**

   This is the ratio that shows the number of times cash collections are made in a given period of time

   I.e. Rate of debtors` turn over =

5. **Creditors` turn over**

   This measures the number of times a business pays its suppliers in a given period of time i.e. a year

   I.e. creditor turnover =

   NB. Creditors` turn over period = **x365days**

   Fixed asset turn over = x100

   Or fixed asset turn over =

LEVERAGE RATIOS

1. **Debtor ratio (debt to asset ratio)**

   This Measures the portion of the business` assets that is financed by debt (obligations to third parties). Debt ratio can also be computed using the formula

   Debt ratio =

2. **Equity Ratio**

   Equity ratio determines the portion of total assets provided by equity (i.e. owners' contributions and the business' accumulated profits). Equity ratio can also be computed using the formula

   Equity Ratio =

3. **Debt-Equity Ratio**

   This evaluates the capital structure of a company. That is to when the ratio is more than 1 implies that the company is a leveraged firm; less than 1 implies that it is a conservative one.

Debt-Equity Ratio =

4. **Times Interest Earned**

   Measures the number of times interest expense is converted to income, and if the company can pay its interest expense using the profits generated. EBIT is earnings before interest and taxes. It's given by

Times Interest Earned =

VALUATION AND GROWTH RATIOS

1. **Earnings per Share**

   EPS shows the rate of earnings per share of common stock. A preferred dividend is deducted from net income to get the earnings available to common stockholders. It's given by

   Earnings per Share =

2. **Price-Earnings Ratio**

   It's used to evaluate if a stock is over- or under-priced. A relatively *low P/E ratio* could indicate that the company is under-priced. Conversely, investors expect high growth rate from companies with *high P/E ratio*. It's given by

   Price-Earnings Ratio =

3. **Dividend Pay-out Ratio**

   It determines the portion of net income that is distributed to owners. Not all income is distributed since a significant portion is retained for the next year's operations.

   Dividend Pay-out Ratio =

4. **Dividend Yield Ratio**

   Measures the percentage of return through dividends when compared to the price paid for the stock. A high yield is attractive to investors who are after dividends rather than long-term capital appreciation. It's given by

Dividend Yield Ratio =

WORKED EXAMPLES one

The following financial statements relates to melon enterprises LTD

MELON ENTERPRISES LTD
Income statement for the year ended 30 June 20117

		Shs
Sales		850,000,000
Less cost of sales		610,000,000
Gross profit		**240,000,000**
Less operating expenses		
Administrative costs	72,000,000	
Selling and distribution costs	50,000,000	
Other costs	18,000,000	
Total costs		140,000,000
Profits before tax		100,000,000
Less taxation 30%		30,000,000
Profit after tax	**70,000,000**	

MELON ENTERPRISES LTD

Balance sheet
As at 30 June 20117

NET FIXED	SHS
Motor vehicles	120,500,000
Land and premises	100,000,000
Furniture and fittings	80,400,000
Equipment	60,100,000
Total fixed assets	**361,000,000**
Current assets	
Inventory	35,500,000
Debtors	64,900,000
Prepayments	6,200,000
Bank	45,400,000
Total current assets	152,000,000
Total assets	**513,000,000**
Capital and liabilities	
Capital	
Owner`s equity	200,500,000
Liabilities	
5year loan	130,000,000
Creditors	152,500,000
Unpaid taxes	30,000,000
Total capital and liabilities	**513,000,000**

Required;

a) Compute the following ratios
b) Gross profit margin
c) Net profit margin
d) Profit on total asset ratio
e) Current ratio

f) Acid test ratio
g) Fixed asset turn over
h) Debtor's turnover

The enterprise apply for loan of shs 40,000,000 repayable within six month
Should the bank give given the current ratio?

SOLUTION

Gross profit margin = **x** 100
= =28.24% or 28%

Net profit margin = **x100**= = 8.24% or 8%

Profit on total asset ratio= = == 70:513 or 0.14:1
Or
Profit on total assets ratio = **x100** =x100 =13.64% or 14%

Current ratio =

But current liabilities = creditors +unpaid tax
= 152,500,000 +30,000,000
=182,500,000

Therefore current ratio = =0.83:1
Or
Current ratio =x100 =x100 =83%

Acid test ratio = === 0.6:1

Or
Acid test ratio = x100

=

X100

=64%

Fixed asset turn over = **x1**00= x100

=235.46%
Or
Fixed asset turn over = =2.35:1

Debtors turn over =**x**100 =1309.7%

Or
Debtors turn over = **=** =13.1:1

The Bank should reject the loan application
The reason is that the business`s current assets are less than the current liabilities
Or
The current asset ratio is below the standard ratio of 2:1

EXAMPLE 2

The following balance was extracted from the final statements of JAK`S business at the end of the 2015

	Shs
Sales	288,000,000
Total fixed assets	65,500,000
Average debtors	90,000,000
Opening stock	40,200,000
Closing stock	50,400,000
Cost of sales	201,600,000
Total current assets	36,100,000
Equity capital	68,400,000
Total current liabilities	16,800,000
Net profit before interest and tax	40,600,000
Long term liabilities	38,500,000
Interest expenses for the year	5,700,000

Required;

a) Compute the following ratios
b) Gross profit margin
c) Stock turn over
d) Debtor’s collection days
e) Leverage ratio
f) Working capital ratio
g) Net profit margin
h) Interest cover

SOLUTION

Gross profit margin= **x100**

But gross profit =Net sales –cost of sales
Shs 288,000,000-201600, 000
86,400,000
= 30%

Stock turn over =

But average cost =

=45,300,000
=4.45 times

Debtors collection days=
X365 days = 114 days

Leverage ratio= x 100= x100 =56.3%

Interest cover == = 7.12 times

Working capital ratio = =2.15:1

Net profit margin =x100

X100

X100=12.11%

Example 3

The following balances were extracted from BAM SHOPPING`s books of account on 31 12 2017

PARTICULARS	SHS
Net sales	20,000,000
Net purchases	11,000,000
Goods available for sale	16,000,000
Stock on 1.Jan 2017	5,000,000
Stock on 31 Dec 2017	4,000,000
Total operating expenses	6,000,000
Total fixed assets	8,000,000
Debtors	1,500,000
Creditors	3,000,000
Cash	900,000
Outstanding rent	1,000,000
Bank	1,600,000

Required

Calculate and interpret the following ratios

a) Inventory turnover ratio
b) Credit payment period
c) Rate of return on capital employed
d) Stock turnover period
e) Cash ratio
f) Profit mark up

Solution
Inventory turnover =
But cost of sales = goods available for sale –closing stock

= 2.3 or 3 times

Interpretation the business sells and replaces its stock 3 times in the trading period

ii) Credit payment period = x number of days in a year
x365 days =99.5 days

Interpretation on average the business takes 100days to pay its creditors

iii) Rate of returns on capital employed = x100

But net profit = (net sales –cost of sales)- expenses

X100 = 16.7%

Interpretation; for 100 shs of capital employed, the business gets shs 16.7 as net profits

iv).Stock turn over period x number of days in a year
X365 days =137 days
Interpretation: the business holds stock for 137 days before its sold

Cash ratio = =
=0.625:1
Interpretation: the business can clear 0.6 of its current liabilities using its absolute liquid assets

v) Profit margin =x 100 =x100 =66.6% or 67%

Interpretation: for every shs 100 of cost of sales the business generates shs 67 as gross profits

The following information was extracted from the records of promela traders for the period ended 31/12/2016.

	Shs
Inventory 01/012016	6,000,000
Inventory 31/12/2016	5,000,000
Inventory turnover ratio	3times
Turnover	30,500,000
Net profit ratio	20%
Delivery van	1,800,000
Fixtures and fittings	1,000,000
Debtors	1,650,000

Creditors	2,500,000
Insurance due	1,500,000
Equipment	250,000
Bank balance	750,000
Cash balance	600,000

Required to

Calculate

a) Cost of sales
b) Net purchases
c) Goods available for sale
d) Total operating expenses

b) Compute and interpret

a) Current ratio
b) Quick asset ratio
c) Credit collection period in weeks
d) Fixed asset turnover ratio

Solution

a) Cost of sales =stock turn over x average stock

But average stock = == shs5,500,000

Hence cost of sales =3x5, 500,000 = shs 16,500,000

ii) Net purchases =cost of sales +closing stock- opening stock

= shs 16,500,000+5,000,000- 6,000,000
= shs 21,500,000- 6,000,000
Shs 15,500,000

iii) Goods available for sale =opening inventory + net purchases

6,000,000+15,500,000

Shs 21,500,000

iv)Total operating expenses = gross profit –net profit.

But gross profit =turn over – cost of sales= shs30, 500,000- 16,500,000= shs 14,000,000
Also net profit = net profit ratio x turn over =x30, 500,000 = shs 6,100,000

Hence total operating expenses =14,000,000 – 6,100,000 = **shs 7,900,000**

Current ratio

but current assets = stock +debtors+ Bank balance + cash balance

Shs 5,000,000 +1650,000+ 750,000= 8,000,000
Also current liabilities = creditors +insurance due

2,500,000 +1,500,000
Shs 4,000,000
Current ratio = = 2:1
Interpretation: the business is in position to pay its current liabilities 2 times using its current assets

Quick ratio= ==

3:4 or 0.75: 1

Interpretation: the business does not have enough quick assets to clear its current liabilities since the ratio is below the standard ratio

Credit collection period in weeks
Fixed asset turnover ratio ==
= 10:1

Interpretation: for every 1 shs invested in business it generates shs 10 as sales revenue

The following balances were extracted from MUKENE'S books of accounts on 31/12/2015.

	Shs (000)
Net sales	20,000
Net purchases	11,000
Goods available for sale	16,000
Stock (01.01.2015)	5,000
Stock (31.12.2015)	4,000
Total operating expenses	6,000
Total fixed assets	8,000
Debtors	1,500
Creditors	3,000
Cash	900
Accrued rent	1,000
Bank	1,600

Required:
Calculate and interpret
i. Inventory turnover ratio
ii. Credit payment period
iii. Rate of return on employed capital

iv. Stock turnover period
v. Cash ratio
vi. Profit marl – up

SOLUTION

Inventory turnover (ratio)/Rate of stock turn/ stock turnover

$$= \frac{\text{cost of sales}}{\text{Average stock}}$$

Cost of sales = Goods available for sale – Closing stock

= 16,000,000 – 4,000,000

=Shs 12,000,000

$$\text{Average stock} = \frac{\text{opening stock + closing stock}}{2}$$

= 5,000,000 + 4,000,000 = Shs 4,500,000

$$\text{Inventory turnover ratio} = \frac{12,000,000}{4,500,000}$$

= 2.7

= 3 times / turns

Interpretation: The business sells and replaces its stock approximately 3 times in a trading period.

(ii) Credit payment period $= \frac{\text{creditors}}{\text{Net purchases}} \times$ Number of days / weeks/ months in a year

$$= \frac{\text{creditors}}{\text{Net purchases}} \times \text{Number of days in a year}$$

$$= \frac{3,000,000}{11,000,000} \times 365$$

= 99.5

= 100 days

Interpretation: On average the business takes 100 days to pay its creditors suppliers

(iii) Rate of return on employed capital

$$= \frac{\text{Net profit}}{\text{Employed capital}} \times 100$$

Net profit = Gross profit – Total operating expenses

= Net sales - Cost of sales) – 6,000,000
= (20,000,000 – 12,000,000) – 6,000,000
= 8,000,000 – 6,000,000
= Shs 2,000,000

Employed capital = Total fixed assets / fixed assets + working capital
But working capital = Total current assets – Total current liabilities.
Total current assets = Closing stock = Debtors = Cash + Bank
= 3,000,000 = 1,000,000
= shs 4,000,000
Working capital = 8,000,000 – 4,000,000
= shs4, 000,000

Employed capital = 8,000,000 + 4,000,000
Shs 12,000,000
Rate of return on employed capital $= \frac{2,000,000}{12,000,000} \times 100$
16.7%

EXERCISE ONE

The following information relates to the books of dingi dingi entertainers as at 30 June 2012

	Shs
Net sales	4,500,000
Cost of sales	3,225,000
Salaries and wages	600,000
Discount received	150,000
Discount allowed	225,000
Machinery	40,000,000
Debtors	7, 200,000
Creditors	12000,000
Cash at bank	8,000,000
Bank over draft	3,200,000
Closing stock	4,800,000

Calculate

i) Gross profit
ii) Net profit
iii) Liquidity
iv) Quick acid ratio

EXERCISE TWO

The following information was obtained from the books of wekasa enterprises as at 31 Dec 2015

OPENING STOCK	100,000

Capital	1,000,000
Cash	105,000
Bank	425,000
Premises	595,500
Creditors	150,000
3year loan	500,000
Wages and salaries	50,000
Purchases	303,500
Carriage inwards	100,000
Motor van	330,000
Returns out wards	60,000
Debtors	92,500
Sales	465,000
Returns inwards	10,000
Interest on loan	20,000
Rent income	115,000
Transport	25,000
Rent expenses	30,000
Drawings	131,500
Machinery	75,000
Commission on sales	10,000
Carriage outwards	20,000
Commission income	135,000

Additional information:

a) Stock at 31 Dec 2015 was shs 60,000
b) Accrued rent shs 60,000
c) Wages shs 2,500 were paid in advance
d) Commission of shs 15, 000 was not yet received
e) Rent income of shs 50,000 was paid in advance
f) Depreciate machinery and motor van by 10% p.a on cost
g) Net profit is shs 78,500

Required to;

Prepare the balance sheet as at 31 DEC 2015

Calculate and interpret the following

a) Average collection period for debts
b) Number of days stock was held before selling
c) Rate of returns on capital employed
d) Rate of stock turn

EXERCISE THREE

The following balances were extracted from the financial statement of Nabikooli traders at the end of 2016

PARTICULARS	**SHS**
Cash	2,010,000

Bank	(600,000)
Sales	35,000,000
Purchases	9,500,000
Average stock	4,000,000
Rate of stock turn	5 times
Fixed assets	5,000,000
Accounts payable	450,000
Closing stock	2,500,000
Accounts receivable	6,590,000
Total operating expenses	8,750,000
Interest receivable due	50,000

Requiredto:
Calculate;
Cost of sales
Gross profit
Net sales
Opening stock
Net profit ratio
Working capital
Stock holding period in weeks
Rate of creditors turn over
Quick asset ratio
Debtor's collection period in days

EXERCISE FOUR

The following balances were extracted from the financial statements of kaliro metal works at the end of the year 2017

Details	**shs**
Turnover	160,000,000
Net purchases	84,000,000
Accounts receivable	7,000,000
Accounts payable	5,800,000
Stock 1/1/2017	3,600,000
Stock 31/12/2017	4,200,000
Total operating expenses	12,000,000
Noncurrent assets	14,400,000
Owners` equity	48,000,000
Bank	3,200,000
Cash	1,000,000
Outstanding rent income	2,400,000
Accrued electricity	2,000,000
Interest on loan expense	1,200,000
Bank loan	4,000,000

Required: compute and interpret the following ratios for the business
Profit mark up

Profit margin
Net profit ratio
Credit payment period in weeks
Debtors' days
Return on equity
Inventory turnover ratio
Stock turnover period
Current ratio
Interest cover ratio
Noncurrent assets turnover
Gearing /leverage ratio
Cash ratio

2 CASH FLOW STATEMENTS

DEFINITION OF CASH FLOW STATEMENT

'Cash Flows' implies movement of cash in and out due to some non-cash items.

BENEFITS OF CASH FLOW STATEMENT

1. It provides a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilize those cash flows.
2. A cash flow statement provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency)
3. Cash flow information is useful in assessing the ability of the enterprise to generate cash and cash equivalents, which enables users to develop models to assess and compare the present value of the future cash flows of different enterprises.
4. It is useful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and the impact of changing prices.
5. **Cash flow statement help in making financial decisions. E.g.** buying capital equipment using cash or pay workers.
6. It helps the financial managers to make a cash flow projection for immediate future, e.g. basing on the past financial projections.
7. Cash Flow Statement is an important financial tool for the management to make an estimate relating to cash for the near future.
8. It helps the internal management to determine the financial policy to be adopted in future, since it supplies information relating to funds, e.g., taking decision about the replacement of fixed assets or repayment of long- term liabilities etc
9. It reveals the cash position for the business, as it shows the movement of cash in the business i.e., whether there is any increase in cash or decrease in cash and the reasons explaining so.
10. Cash flow statement helps to identify the main financial sources for the business that is from where cash inflows have arisen within a particular period and also shows the various activities where in the cash was utilized as Cash Flow Statement does not always represent the real liquid position.
11. Cash flow statement is significant to management for proper cash planning and maintaining a proper matching between cash inflows and outflows. As

Cash flow statement reports the amount of cash received during the period through various financing activities, such as issue of shares, debentures and raising long-term loan.

12. Cash flow statement helps in appraising of the various capital investment programs to determine their profitability and viability.

Limitations of Cash Flow Statement:

Cash Flow Statement is, no doubt, is an important tool in financial management which explains the movement of funds in various ways of a firm. It assists the management to understand the amount of capital blocked up in a specific segment of a firm. Although the Cash Flow Statement performs as an important financial tool, it is even not free from limitations.

Some of them are given below:

1. Cash Flow Statement fails to present the net income of a firm since it does not consider non-cash item.
2. It is neither a substitute of Funds Flow Statement nor an Income Statement. So, the functions which are performed by the Funds Flow Statement or Income Statement cannot be done by the Cash Flow Statement.

Terms

1. **Cash,** it comprises cash on hand and demand deposits with banks.
2. **Cash equivalents**, these are short term, highly liquid investments that are readily convertible into known amounts of cash.
3. **Cash flows**, these are inflows and outflows of cash and cash equivalents.
4. **Operating activities**, these are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.
5. **Investing activities,** these are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.
6. **Financing activities**, these are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise.
7. **Cash inflow**, these are Receipt of cash from a non-cash item.
8. **Cash out flows**; this is cash payment in respect to in terms such as, purchase of machinery by paying cash.

CLASSIFICATION OF ACTIVITIES FOR THE PREPARATION OF CASH FLOW

There are activities of an enterprise result into cash flows (inflows or receipts and outflows or payments). These activities are to be classified into three categories:

Operating,
Investing,
Financing activities

OPERATING ACTIVITIES

Cash flows from operating activities are primarily derived from the main activities of the enterprise. They generally result from the transactions and other events that enter into the determination of net profit or loss.

Cash Inflows resulting from operating activities include,

- Cash receipts from sale of goods and the rendering of services,
- Cash receipts from royalties,
- Fees,

- Commissions
- Loan acquisition
- Sale of long term asset,
- And any other income that businesses receive

Cash Outflows resulting from operating activities include;

- Cash payments to suppliers for goods and services,
- Cash payments to and on behalf of the employees,
- Cash payments to an insurance enterprise for premiums,
- Claims,
- Payment for policy benefits,
- Cash payments of income taxes,
- Interest payments on acquired loans,
- Payments for utilities
- Purchase of fixed assets

INVESTING ACTIVITIES

Transactions related to long-term investment are (investing activities).

Separate disclosure of cash flows from investing activities is important because they represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Hence

Cash Inflows resulting from Investing Activities include;

- Cash receipt from disposal of fixed assets,
- Cash receipt from the repayment of advances or loans made to third parties (except in case of financial enterprise).
- Cash receipt from disposal of shares, warrants or debt instruments of other enterprises except those held for trading purposes.
- Interest received in cash from loans and advances.
- Dividend received from investments in other enterprises.

Cash Outflows from investing activities;

- Cash payments to acquire fixed assets,
- Cash payments to acquire shares, warrants or debt instruments of other enterprises other than the instruments those held for trading purposes.
- Cash advances and loans made to third party (other than advances and loans made by a financial enterprise wherein it is operating activities).

FINANCING ACTIVITIES

Financing activities relate to long-term funds or capital of an enterprise, e.g., cash proceeds from issue of equity shares, debentures, raising long-term bank loans, repayment of bank loan, etc. here;

Cash Inflows from financing activities include;

- Cash proceeds from issuing shares (equity or/and preference).
- Cash proceeds from issuing debentures, loans, bonds and other short/
- Long-term borrowings

Cash Outflows from financing activities include;

- Cash repayments of amounts borrowed.
- Interest paid on debentures and long-term loans and advances.
- Dividends paid on equity and preference capital.

Components of Balance sheet
Balances
Total inflows
Total out flows
Net cash position

EXAMPLE ONE

The following projections relates to makalanda traders for the 2017

i. Share capital shs 600,000 as 1 march 2017
ii. Cash sales for March 2017 shs 8,250,000 and expected to increase by shs750, 000
iii. Monthly debts to be collected are shs 2,000,000 and expected to increase by shs 200,000 per month
iv. A loan worth shs 7500,000 to acquired from tropical bank in April 2017
v. Monthly credit sale shs 4,000,000, But 60% will be paid in the month of sale and balance to be paid in the following month.
vi. Start up equipments worth shs 7,500,000 to be bought in April 2017
vii. Monthly expenses for servicing of refrigerators are expected to be shs 200,000
viii. Monthly payments are salaries shs 2,250,000 security shs 750, 000, insurance shs 225,000
ix. Monthly utility bills of shs 750,000 are to be made
x. Monthly loan repayment shs 900,000 will start in may
xi. Purchases are expected to shs 2,000,000 monthly

Required;

Prepare a cash flow statement for makalanda for the period from May to June 2017

Give any five importance of the cash flow statement to kalanda traders

MAKALANDA TRADERS`

Cash flow statement

For the period from March to June 2017

DETAILS	MARCH SHS	APRIL SHS	MAY SHS	JUNE SHS
Balance b/f		775,000	9,800,000	18,150,000
Add cash inflows:				
Share capital	600,000			
Cash sales	8,250,000	900,000	900,000	900,000
Receipts from debtors	2,000,000	2,200,000	2,400,000	2,600,00
		7,500,000		
Loan	2,400,000	4,000,000	4,000,000	4,000,000

	13,250,000	**21,675,000**	**24,125,000**	**34,125,000**
		7,500,000		
	200,000	200,000	200,000	200,000
	2,250,000	2,250,000	2,250,000	2,250,000
	750,000	750,000	750,000	750,000
	225,000	225,000	225,000	225,000
	750,000	750,000	750,000	750,000
	6,300,000			
			900,000	900,000
	2,000,000	2,000,000	2,000,000	2,000,000
	12,475,000	**13,675,000**	**7,050,000**	**7,050,000**
	775,000	9,800,000	18,1150,000	26,675,000

EXAMPLE TWO

Mbale maize millers had the following projections for the year 2018
Opening cash balance as at 1 January 2018 shs 2,200,000
Sales in kg;
January 90,000
February 100,000
March 80,000
April 20,000, each kg is to be sold at shs 500 on cash basis.
The business plans to obtain a loan of shs 10,000,000 at an interest rate of 15% from Bank of Baroda. The loan is in two installments shs 6,000,000 in February and shs 4,000,000 in April.
Receipts from debtors are projected at shs 2, 000, 000, shs 900,000 and shs 400,000 from the months of February, March and April respectively.
Purchases of raw materials in kgs is projected as follows January 6000, February 7000, march 8000 and April. The material is expected to cost shs 2000 per kg.
Labour costs for January is shs 2, 000, 000, February shs 1,800,000, March shs 1,700,000 and April shs 1,950,000.
Production expenses are projected as January shs 500, 000, February shs 400,000, March shs 300,000 and April shs 450,000.
Monthly administrative and marketing expenses are shs 300,000.
A generatoris be bought at shs 20,000,000 on credit in January .50% of the cost is to paid in march and the balance in April 2018.
Provision for bad debts anduncertainties is provided for at shs 70,000,000

Required: prepare mbale maize millers cash flow statement for the months of January, February, March and April 2018
Suggest ways of minimizing cash deficit in the busines

MBALE MAIZE MILLERS`
Cash flow statement
For the months of January, February, March and April 2018

DETAILS	JANUARY Shs	FEBRUARY Shs	MARCH Shs	APRIL Shs
Balance b/f	2,200,000	32,400,000	73,900,000	86,500,000
Add cash inflows				
Cash sales	45,000,000	50,000,000	40,000,000	10,000,000
Loan		6,000,000		4,000,000
Receipts from debtors		2,000,000	900,000	400,000
Total cash inflows	**47,200,000**	**90,400,000**	**114,800,000**	**100,900,000**
Less **CASH OUTFLOWS**				
Purchase of raw materials	12,000,000	14,000,000	16,000,000	18,000,000
Labour costs	2,000,000	1,800,000	1,700,000	1,950,000
Production expenses	500,000	400,000	300,000	450,000
Administrative and marketing expenses	300,000	300,000	300,000	300,000
Purchase of generator			10,000,000	10,000,000
Total cash outflows	14,800,000	16,500,000	28,300,000	30,700,000
Net cash position	32,400,000	73,900,000	86,500,000	70,200,000

EXAMPLE THREE

The following were projections of john musoga traders for the months of March,April,May and June 2017

i. The business had a net cash deficit of shs 60,000,000 at the end of February 2017
ii. Expected monthly cash sales are to amount to shs 20,000,000.the cash sales are expected to decrease by 20% after the first two months. Credit sales were projected at shs 8,000,000 monthly with 60% of payments expected in the month of sale and the balance in the following months less 10% discount.
iii. Monthly cash purchases are expected to be shs 12,000,000.this was expected to increase by 12% monthly basing on projected demand.
iv. Monthly credit purchases are expected to be 40% of total monthly sales whose payments are to be made in the following month less 5% discount.
v. A monthly salary for 20 workers was expected to be shs 400,000 per worker. Two workers are to be terminated at the end of the second month and no replacement is expected to be made
vi. The business planned to get a loan of shs 16,000,000 in the first month with a repayment grace period of one month after acquisition. Its payable is in two equal installments with an interest rate of 10% payable on reducing balance method.
vii. The business planned to sell old machinery worth shs 4,000,000 in May and receive initial payment of shs 1,800,000 and the balance in the following month. The depreciation is at a rate of 5%per annum

viii. Rent receivable was to increase by 10%monthly .rent received at the end of February was shs 1,000,000
ix. A coolerworth shs 10,000,000 was to be bought in March on hire purchase basis. Down payment of shs 4,000,000 was to be made and the balance to be paid in the ratio of 2/4, 1/4 and 25% the coming month repetitively
x. Advertisements of shs 3,000,000 were to be paid for at the end of June 2017
xi. Creative sales persons are to receive commission of 5% of the month's cash sales revenue
xii. Any cash shortage is to be offset with debenture at the beginning of the next month with an interest rate of 10% per month for 4months payable together with the debenture after 4 months from the month of debenture acquisition

Required

Prepare the cash flow statement for the business for the period of March to June 2017

Comment on the trend of net cash position of the business

Advise the business on the measures to adopt to overcome any cash deficit

JOHN MUSOGA TRADERS
CASH FLOW STATEMENT
FOR THE MONTHS OF MARCH, APRIL, MAY AND JUNE 2017

DETAILS	**MARCH SHS**	**APRIL SHS**	**MAY SHS**	**JUNE SHS**

Cash balance	(60,000,000)	(43,100,000)	(7,430,000)	(18,221,800)
Add cash inflows;				
Cash sales	20,000,000	20,000,000	16,000,000	16,000,000
Receipts from debtors	4,800,000	8,000,000	8,000,000	8,000,000
Loan	16,000,000			
Rent receivable	1,100,000	1,210,000	1,331,000	1,464,100
Sale of old machinery			1,800,000	2,200,000
Debenture		43,100,000	17,430,000	18,221,800
Total cash inflows	**18,100,000**	**29,210,000**	**27,131,000**	**22,664,100**
Less :cash out flows				
Cash purchases	12,000,000	13,440,000	15,052,800	16,859,136
Payment to creditors		11,200,000	1,552,800	16,859,136
Workers salaries	8,000,000	8,000,000	7,200,000	7,200,000
Loan principal payment		8,000,000		8,000,000
Interest on loan		1,600,000		800,000
Purchase of cooler	4,000,000	3,000,000	1,500,000	1,500,000
Advertisements				3,000,000
Commission	1,000,000	1,000,000	800,000	800,000
Total cash out flows	**25,000,000**	**36,640,000**	**45,352,800**	**47,759,136**
Net cash position	**(43,100,000)**	**(7,430,000)**	**(18,221,800)**	**(20,095,036)**

NET CASH POSITION

John musoga had a deficit of shs 43,100,000 by the end of March 2017

It reduced to a deficit of shs 7,430,000 by the end of April 2017

The business also had a deficit of shs 18 221,800 by thee of May

The business performance for four month was not good

WAYS OF REDUCING DEFICIT

By postponing increase in expenditures e.g. salaries

Selling off some of the fixed assets

Increasing on cash sales

Speeding up debt collection

Selling on cash only

Obtaining loan from low interest rate sources

Laying off some workers

Negotiating for longer credit period for supplies

EXAMPLE FOUR

The following information relates to projections made by mbale venders` association for the months of January, February, march and April 2018

Projected cash and bank balances as at December shs 20,000,000

Sales will be both cash and credit. January cash sales will be 800 units at price of shs 10,000 each. Thereafter, cash sales will be increase at a rate of 5% per month. Credit sales for each month are expected to be shs 5,500,000.debtors will be expected to pay in the month of sale.

The business plans to buy 15 computers at shs 650,000 each in March. And import duty of 5% on total cost will be paid in addition.

Monthly expected expenses and payments include salaries and wages shs 30, 000, 000, machine servicing shs 300, 000, depreciation shs 100,000.salaries for April will be paid in the month of March.

The business is paying back a loan of shs 10,000,000 previously obtained. Monthly installments amountto shs 2,000,000 per month starting in February. The loan attracts interest of shs 100,000 per month also payable starting February

The business will buy 900 units of raw materials at shs 6,000 each in the month of January. The quantity of raw materials is expected to increase by 10% every month. Purchase of raw materials is strictly on cash basis.

The business expects to receive shs 10,000,000 as a donation in April and plans to sell off an old motor van at shs 9,000,000 in March.

Required; prepare Mbale vendors` association`s cash flow statement for the period of January to April 2018

MBALE VENDORS` ASSOCIATION`S

Cash flow statement

For the period of January, February, March and April 2018

Details	January shs	February shs	March shs	April Shs
Balances b/f	20,000,000	(2,200,000)	(26,640,000)	(75,851,000)
Add cash inflows				
Cash sales	8,000,000	8,400,000	8,820,000	9,261,000
Receipt from debtors	5,500,000	5,500,000	5,500,000	5,500,000
Cash donations				10,000,000
Sale of old vehicle			9,000,000	
Total cash outflows	**33,500,000**	**11,700,000**	**(3,320,000)**	**(51,090,500**)
Less cash outflows				
Purchase of computer		9,750,000		
Import duty		487,500		
Salaries and wages	30,000,000	30,000,000	60,000,000	
Machine servicing	300,000	300,000	300,000	300,000
Loan repayment		2,000,000	2,000,000	2,000,000
Loan interest payment		100,000	100,000	100,000
Purchase of raw materials	5,400,000	5,940,000	6,534,000	7,187,400
Total cash outflows	**35700,000**	**38,340,000**	**79,171,500**	**6,677,900**
Net cash position	2,200,000	26,640,000		

EXAMPLE FIVE

I. Nkoma trading company ltd which plans to start a business has availed the following projected details for the first six months of the year 2017
II. Cash at bank shs 4,000,000 at 1 January 2017
III. Cash sales for January 2016 shs 5,500,000.the sales are expected to increase by shs 500,000 every month. All sales will be by cash
IV. Capitalization loan to be acquired from bank of Baroda in February,2017 shs 5,000,000
V. Purchases of startup assets during the month of February 2017 shs 5,000,000
VI. Monthly payments starting with January 2017, salaries and wages shs 1,500,000,rent shs 500,000 advertising shs 150,000
VII. Pre –operating expenses to be paid January 2017 shs 200,000
VIII. Purchases occur in the month of sale are expected to be 75%of each month`s projected sales. Purchases will be paid for after one month

NKOMA TRADING COMPAN LTD`S

CASH FLOW STATEMENT

FOR THE MONTHS OF JANUARY, FEBRUARY, MARCH, APRIL MAY AND JUNE 2016

PARTICULARS	JANUARY SHS	FEBRUARY SHS	MARCH SHS	APRIL SHS	MAY SHS	JUNE SHS
Balancce b/f	-	3,150,000	7,000,000	7,225,000	7,575,000	8,050,000
Add cash inflows;						
Share capital	4,000,000					
Cash sales	5,500,000	6,000,000	6,500,000	7,000,000	7,500,000	8,000,000
Capitalization		5,000,000				
Total cash inflows	**9,500,000**	**14,150,000**	**13,500,000**	**14,225,000**	**15,075,000**	**16,050,000**
Less cash out flows;						
Purchase up startup assets		5,000,000				
Salaries and wages	1,500,000	1,500,000	1,500,000	1,500,000	1,500,000	1,500,000
Rent	500,000	500,000	500,000	500,000	500,000	500,000
Advertising	150,00	150,000	150,000	150,000	150,000	150,000
Pre operating expenses	4,200,000					
Loan repayment						600,000
Purchases			4,125,000	4,500,000	4,875,000	5,250,000
Total cash outflows	**6,350,000**	**7,150,000**	**6,275,000**	**76,650,000**	**7,025,000**	**8,000,000**
Net cash position	**3,150,000**	**7,000,000**	**7,225,000**	**7,575,000**	**8,050,000**	**8,050,000**

Uses of cash flow to the business

It enables the business to fore cast cash challenges in advance

It enables management to compare actual with the projections.

It portrays the ability of the business to repay loan obligations
It's used to show changes in the net cash positions of the business from one period to another
It enables the business to indentify the various needs and provides sources of funding
It facilitate proper planning for the business regarding investment decisions

EXERCISE ONE

The following projections relate to mbale AGRO chemicals enterprises during the months of May, June, July and August 2017

I. On may 1 2017, theenterprise had a cash balance of shs 40,000,000 and bank balance of shs (8,000,000)
II. Outputs of 600 units, 750, units and 950 units each at shs 1,200 were to be sold in the months of MayJune, July, and August on cash basis
III. Monthly credit sales were projected to be 25% of cash sales but payment would be received next month less 5% discount.
IV. Donations were projected as follows; may shs 1, 000, 000, June shs 1, 800, 000, July 1,500,000 August 3,000,000 (inform of physical goods).
V. The business receives monthly rent income from its property .rent received on 30 June was shs 600,000 but this was expected to increase by 10% after one month.
VI. Inputs of 500,800,1100,14 units were to purchases at shs 950 each on cash basis
VII. Monthly expenses were projected as follow; utilities shs 250,000, VAT shs 180,000 and advertising shs 100,000.however no VAT was paid in July.
VIII. Credit purchases of shs 900,000 were made in June,the businesshas a policy 0f paying for credit purchases in 2 equal installments after one month.
IX. The business has a policy of paying a 5% sales commission on the total monthly sales. No commission was paid in the first two months.

Required: prepare mbale agro chemical cash flow statement for four months
Advise the enterprise on managing a cash surplus

EXERCISE TWO

Mooni electronic centre presented the following cash inflows and cash outflows for the month of August 2017

August 2017		**shs**
Balance b/d	8,400,000	
Cash inflows:		
Cash sales		250,000,000
Cash collected from debtors		43,000,000
Loan from centenary bank		30,000,000
Penalties for delayed payments		1,500,000

Commission income	6,000,000
Interest on cash deposits	500,000
Donations and grants received	30,000,000
Total cash inflow	**369,400,000**
Cash outflows	
Purchases of stock	110,000,000
Labour costs	60,000,000
Power and utilities	5,000,000
Administrative costs	1,500,000
Payments of creditors	50,000,000
Purchase of machinery	21,000,000
Total outflows	**247,500,000**

Additional information

I. The following projections were provided for the months of September, October and November 2017.

II. Cash sales revenue is expected to increase by 5% in September and October. It will drop by shs 500,000 in the month of November.

III. Cash collections from debtors will increase by 10% in September and October. No cash will be received from debtors in the month of November

IV. No further loans will be received until December 2017

V. Commission income is expected to double in the month of September and reduce by 1/3 of September`s commission income in the next months.

VI. The business will continue receiving interest on deposits equivalent to what was received In August

VII. Donations and grants were received only in August and no further penalties on delayed payments will be charged.

VIII. Decapitalisation of assets will be done in September and this will generate shs 13,000,000.

IX. Cash purchase of stock will be maintained at the same level in September and October. However it will drop by shs 10,000,000 in the month of November.

X. Labour costs for September October and November will also be the same asthat of August

XI. Power and utilities will also be the same as they appear I August.

XII. There will be increase of shs 500,000 monthly in administrative costs

XIII. The business is expected to start paying corporation tax every month of shs 2,000,000.however this will be paid as a single sum in November

XIV. The loan acquired in August will be paid back in six installments starting in the month of September

XV. The business will pay a monthly interest on the loan at a rate of 5% on reducing balance of starting in September.

XVI. The business will donate shs 1,000,000 to good hope children centre in September.tis will increase by 4% every month

XVII. The proprietor is expected to use shs 1,600,000 every month for family needs starting in October 2017

Required: prepare a cash flow statement for Mooni electronic centre for the months of September, October, and November 2017.

EXERCISE THREE

The following information relate to the books kamboozi enterprise ltd projection for the months of July, August, September and October 2018

I. On July 1 2018 cash balance is 26,000,000
II. Credit sales are projected to be shs 40,000,000 monthly. However the business credit policy is60% in the month of sale and balance in the following month for all the months.
III. The business hopes to acquire a loan in the month of August and October 2018.
IV. Monthly cash sales are projected to be shs 60,000,000.a commission of 10% is paid to salesmen for the well done each time cash is received
V. Monthly cash purchases worth shs 40,500,000 is expected to be made
VI. A delivery van is to be bought in the month of August at a cost of shs 35,000,000.
VII. Monthly wage bill is estimated to be shs 12,500,000 and expected to increase in the month of October
VIII. A loan interest of 5% per month is payable starting in the month of acquisition of the loan
IX. Expansion of the business premises is expected to cost $2000 and the price of the dollar is shs3500 in the month of July and $100 is set to be spent in the month of August.
X. General expenses are expected to be 7,100,000 per month. All expenses are paid in the month in which they are incurred.
XI. The business is set to pay income tax in the month of September of shs 12,000,000.

Required: prepare cash flow statement for kamboozi enterprise ltd for the months of July, August, September and October 2018

Comment on the net cash position of the business

EXERCISE FOUR

Given the following information of BIG BOSS Enterprises LTD

(i) On 1stJune 2015, the business had cash in hand shs 5 million.
(ii) Cash sales 10 million was expected every month.
(iii) Credit sales are expected to be shs 6 million per month. Debtors will be expected to pay in the month of sale.
(iv) Monthly cash purchases projected to be shs 8 million.
(v) The business plans to get a loan of shs 4 million in the first month at a monthly interest of 10% payable beginning the following month on reducing balance while the principal is to be paid in four equal installments beginning from the third month.
(vi) Monthly salary and wage bill estimated at shs 1 million
(vii) Rend income is expected to be shs shs 2 million per month and this will increase by 20% after the second month.
(viii) Monthly incomes from grants and donations are projected at shs 3 million and this will reduce by 10% after three months.
(ix) Corporation tax is estimated to be shs 500,000 per month but will increase by 10% every month.
(x) The business plans to buy an office safe at shs 8 million in the first month making

down payment of 49%. The remaining amount is to be paid in the ratio of 5:3:2 in the following months.

(xi) The business hopes to issue a debenture of shs 4million every month.

(xii) Monthly expected expenses include;

		shs
i.	Salaries and wages	1,000,000
ii.	Advertising	200,000
iii.	Depreciation	100,000

Xiii The business shall finance any cash shortfall with a loan in the following month.

Required:

(a) Prepare a monthly cash flow statement for four months period.

(b) Advise the proprietor on what to do in case of a deficit in the net cash position.

Controls to manage the flow of funds in a business

Reduce or increase aninventory to match sales requirements

Negotiate with suppliers for an extension of payment dates

Shop for favourableinterest rates funds and availability of fund to borrow.

Control receivables to collect money as soon as possible

Analyze expenses to reduce costs and eliminate waste

Raise prices to increase gross profits or lower them to increase sales volume

Develop good purchasing practices to take advantage of special price and discounts

Take less salary out of the business

Learn to use forecasts to develop useful cash budgets so that cash is able to meet all future obligations

Do not use cash from the business for personal use

BUSINESS TAXES

A tax is a compulsory charge levied by the government or any other competent authority on persons (individuals, corporations or other legal entities) or on business in order to finance government activities. It is the amount of money paid by a business to the taxing central government or the local government.

Taxation is the process through the governments obtains money from eligible persons by application of the law. In Uganda, the role is performed by Uganda revenue authority (URA) for the central government revenue and local administrations for local government taxes.

Importance of taxation in a country

1. Taxes are major sources of government revenue to finance the provision of social services and other development services/projects.
2. It encourages development of local industries and protects them against foreign competition with a view to providing employment and saving foreign exchange, by imposing high duties on competing imports.
3. Taxes help to improve on the balance of payment position e.g. government can increase import duties on certain commodities to discourage their importation.
4. It protects society from undesirable or harmful products and industries by imposing high taxes on them, for instance excise duty on cigarettes and beer as well as environmental levy on used vehicles.
5. Taxes are used to reduce income inequalities in an economy thus ensuring economic stability through stable prices in the economy. This is achieved by levying high taxes on people`s incomes.
6. To finance Government re-current and development expenditure, i.e. paying salaries for civil servants and funding long term projects such as construction of schools, hospitals and roads.
7. it’s used to regulate demand and supply in the economy in times of inflation.
8. It encourages export of goods and services by reducing or removing tax on the export in order to make them more competitive in the world market.
9. Taxation may enable a country to become self-reliant and self-sustaining through the various taxes that may be imposed. Such taxes help to reduce the need for borrowing.
10. To influence allocation of resources, this is done by taxing more sectors that are not a priority and giving tax incentive to priority sectors.
11. Taxes are used to reduce regional imbalances, this is achieved by encouraging firms to set up across the country through tax incentives

Principles of taxation

These refer to rules/guidelines which are followed when developing a tax system. These rules must be followed or observed when assessing, collecting and administering taxes. Taxation is aimed at ensuring that every tax payer contributes a fair share to the cost of government activities.

1. **Simplicity:** The type of tax and method of assessing and collecting taxes have to be simple enough to be under stood by both the tax payers and tax collectors. Complicated.
2. **Equity or fairness:** This means that the tax system hasto be fair sothat the distribution of the tax burden is equitable (equal/evenly distributed). This is applied in two ways i.e. horizontally orvertically.

   Horizontal equity: This means that people who earn same incomepay same amount of tax.

   Vertical: This means that people who earn more pay more tax.
3. **Convenience:** This means that the place, period and the season in which taxes are to be paid have to be convenient to the tax payer. E.g., P.A.Y.E is deducted from the employee`s income at the time the employer is paying the salary
4. **Certainty:** A good tax system is one which ensures that all parties involved know their rights and obligations. A good tax system has to be certain in time and the method and the amount to be paid.
5. **Economical:** This principle aims at ensuring that the cost of collecting tax is kept as low as possible for both the tax collector and the tax payer. For example the tax collector should

not use more than 5% of the amount of taxes being collected.

6. **Ability to pay:** The tax payer has to be able to pay the tax assessed on him without any problem. The taxes to be paid do not have to curtail the operations of the business or affect the standard of living of the tax payer.
7. **Elasticity:** A good tax system changes directly with change in tax base. If the tax base increases, the tax yield has to also increase.
8. **Flexibility:** This principle states that the government has to be able to increase the taxable rates depending on its objectives, needs and policies e.g. if the government is to reduce employment, then the tax rates have to be reduced**.**
9. **Productivity:** This states that the taxes have to yield revenue to the government and the same time government calculates correctly how much tax yield the government is to get using a given tax rate.

   Diversity: This principle states that the system has to cover as many assets as many aspects as possible i.e. the tax system has to cover all people who earn income in different ways.

   Impartiality: This principle states that the tax system does not discriminate among tax payers.

   Neutrality: This principle states that the tax system has not to have serious effects on the economic activities. I.e. the taxes paid do not have to affect resource allocation in the economy/country.

NB: Principles of taxation are sometimes called canons of taxation.

Characteristics/attributes of a good tax system

- Should be comprehensive i.e. it should cover as many aspects of the economy as possible.
- Should be simple and straight to be understood by both the tax payer and the tax collector.
- Should yield adequate revenue to the country.
- Should promote equity of sacrifice i.e. it should ensure that it ensures social and economic justice.
- Should avoid double taxation i.e. It should avoid taxing an item more than once.
- Should direct resources to priority areas hence stimulating savings, investment and productivity.
- Should recognize basic rights of the tax payers i.e. tax payers should not be harassed, inconvenienced and exploited by the taxing authority.
- Should be convenient i.e. it should be made to know when and where to pay the taxes.
- Should be flexible i.e. it should be easy to adjust depending on the changes in the income of the tax payer.
- Should be impartial i.e. it should discriminate among tax payers. Therefore, a good tax system should be productive and it should not discourage the efforts of the tax payers.
- It should be economical i.e. the cost of collecting and administering the tax should not exceed 5% of a tax.
- Should ensure economic stability i.e. it should not cause instabilities in the economy like inflation.

CLASSIFICATION OF TAXES

Taxes can be classified according to proportion of one`s income that is paid as tax, according to the method of calculation of tax or according to the mode of payment.

1. Classification of taxes according to one`s income paid as tax.

a. **Proportional tax,** is one where the tax is constant regardless of the different levels of income e.g. corporation tax which is currently 30%.

b. **Progressive tax** is where the tax rate increases as the income increases. The burden of tax is heavier on higher income earners and lower on low income earners

Progressive taxes reduce the tax incidence of people with lower income as they disproportionately shift the burden to those with higher income.

c. **Regressive tax,** is one where the tax rate decreases as a person`s income increases. The burden is proportionally greatest on lower earner

2. Classification of taxes according to method/mode of calculation of tax.

(a).**Advorolem tax** is measured as a percentage of the price of the imported good. These taxes are usually on the value of goods and services

(b). **specific tax,** is a fixed monetary tax per physical unit of good imported e.g. shs. 100,000 per tone of maize flour

3. Classification of taxes according to type

DIRECT TAXES

A direct tax is defined as the tax where the liability as well as the burden to pay it resides on the same individual. That is the burden of the tax falls directly on the individual who earns a taxable income and cannot shift the tax to others

Types of direct taxes

Income tax, this is a taxLevied on and paid by the same person according to tax brackets as defined by the income tax department. Income tax takes two forms that is;

Personal income tax: Is a tax levied on the income of individuals and it is normally a progressive tax.

Corporate Tax: Paid by companies and corporations on their profits.

NOTE: The tax base for income tax includes profits from business, rent and royalties from letting assets and income from investments like shares, debentures and other securities and income from employment.

Wealth Tax: this is a taxLevied on the value of property that a person holds, e.g. savings of an individual or business entity. It may be levied on land, buildings, shares or other investments.

Inheritance (Estate) Tax: It is a tax on the estate, or total value of the money and property, of a person who has died.

Gift Tax: It is the tax that an individual receiving the taxable gift pays to the government.

Capital gains tax, is defined as a tax charged on the profit realized on the sale of a non-inventory asset that was purchased at a lower price. The most common capital gains are realized from the sale of stocks, bonds, precious metals and property.

Property Tax or millage tax, it is a tax which the owner pays on the value of the property being taxed. Its determined does the appraisal to determine value of the property, and tax to be paid.

Fringe Benefit Tax: Paid by an employer that provides fringe benefits to employees, and is collected by the state government.

DETERMINING INCOME TAX PAYABLE

Example 1

The table below shows the monthly PAYE tax rates in Uganda

Monthly income (shs)	**Tax liability / tax rate**
0 - 235,000	NIL
235,000 – 335,000	10% of the amount by which chargeable income exceeds shs 235,000
335,000 - 410,000	Shs 10,000 plus 20% of the amount by which chargeable income exceeds shs 335,000
Exceeding shs 410,000	(a) Shs 25,000 plus 30% of the amount by which chargeable income exceeds shs 410,000. (b) Where chargeable income exceeds shs 10,000,000 an additional 10% is charged on income exceeding shs 10,000,000.

(a) Calculate the income tax payable by the following employees who earned the following incomes in the month of March 2016.

(i) Dembe shs 235,000
(ii) Mulembe shs 400,000
(iii) Makanika shs 600,000
(iv) musanji shs 11,000,000

Solution

Dembe= tax payable =tax rate x monthly gross salary

Dembe pays nil tax because his earnings is below tax threshold

Mulembe tax payable = Tax rate x gross monthly salary

10,000+ 20/100 (400,000-335,000)
10,000+20/100x 65,000
10,000+13,000
Shs 23,000

Makanika tax payable = tax ratex gross income
25,000+ (600,000-410,000)

25,000+30/100 x 190,000
25,000+57,000
Shs 82,000

Musanji taxpayable = tax x gross salary

25,000+30/100(11,000,000-410,000) +10/100x (11,000,000-10,000,000)
25,000+30/100x (10, 490,000) + (10/100 x 1,000,000)
25,000 +3,177,000+100,000
Shs 3,302,000

Example 2

The following are monthly salaries of workers employed by malika enterprises.

Sefuka Moses	shs 200,000
Bumeke Aisha	shs 284,000
Wessel AK	shs 820,000
Pallaso juma	shs11, 000,000

Each employee receives 10% and 5% as Housing and medical allowances respectively
Compute PAYEE paid by the above employees using tax schedule above
SOLUTION
Ssfukamoses
Taxable income =basic salary +allowances
= 200,000 + housing allowances (10/100 x200, 000) +medical allowances (5/100x 200,000)
= shs 200,000 +28,400 +14,200
Shs 326,000
PAYEE = 10/100 X (326,000-235,000)
=10/100 X91, 600
SHS 9,160
Bumeke Aisha = taxable income = basic salary +allowances
820,000 + housing allowances (10/100 x 820,000 + medical allowances (5/100 x820, 000)
= 820,000 +82,000+ 41,000
Shs 943,000
PAYEE = shs 25,000 +30/100 (943,000-410,000
25,000+30/100 x 533,000
25,000 +159,900
Shs 184,900
Pallaso juma, taxable income = basic salary +allowances
11 000,000 + housing allowances (10/100 x 11,000,000 + medical allowances (5/100 x11, 000,000)
11,000,000 +1,100,000 +550,000
Shs 12,650,000
PAYEE = 25,000 + 30/100 X (12,650,000-410,000) + 10/100 X (12,650,000 -10,000,000
25,000 +30/100 X12, 240,000+10/100 X 2, 65,000

SHS25, 000+3,672,999+265,000

Shs 3,962,000

Example 3

Makanika wange earned the following incomes in shs from different sources for the year 22017

Property income shs 800,000

Business income shs 3,000,000

Employment income shs 4,380,000

Expenses and losses for the year shs 3,000,000

Income that is tax exempt was shs 1,180,000

The following table shows annual chargeable income tax rate

Annual chargeable income (shs)	**Tax liability / tax rate**
Not exceeding shs2,820,000	NIL
Exceeding shs 2,820,000 but not exceeding shs 4,020,000	10% of the amount by which chargeable income exceeds shs 2,820,000
Exceeding 4,020,000 but not exceeding shs 4,920,000	Shs 120,000 plus 20% of the amount by which chargeable income exceeds shs 4,020,000
Exceeding shs 4,920,000	(a) Shs 300,000 plus 30% of the amount by which chargeable income exceeds shs 4,920,000

Determine Makanika wange`s

Gross income

Chargeable income

Income tax paid

Solution

Gross income = income from all sources – tax exempted income

=property income +business income + employment income - income exempted from tax

= shs 800,000 +3,000,000+4,380,000)- 1,180,000

= shs 8,180,000- 1,180,000

= shs 7,000,000

Chargeable income = gross income – total losses and expenses

=shs 7,000,000 -3,000,000

=shs 4,000,000

Income tax= tax rate x chargeable income

10/100 x (4,000,000- 2,820,000)

10/100 x 1,180,000

= Shs 118,000

Example 4

The following income records relates to bekasa hotel

Income earner	Employment income shs	Business income shs	Property income shs
MUTOMBE ALI	1,000,000	2,000,000	3,400,000
NEKESA AISH	800,000	1,900,000	2,700,000
MEKKA HASSAN	1,200,000	2,100,000	3,800,000
OKELLO BOB	600,000	1,400,000	2,300,000

For each of the above income earned the tax exempted is 8% of their total income. While the expenses take 12% of the total income

Determine

Gross income

Taxable income

b) The business aiso had the following records for workers earnings for the year

Okello shs 750,000

Wambwa shs 310,000

Olupot shs 1,500,000 per month

Monthly income (shs)	**Tax liability / tax rate**
0 - 235,000	NIL
235,000 – 335,000	10% of the amount by which chargeable income exceeds shs 235,000
335,000 - 410,000	Shs 10,000 plus 20% of the amount by which chargeable income exceeds shs 335,000
Exceeding shs 410,000	(a) Shs 25,000 plus 30% of the amount by which chargeable income exceeds shs 410,000. (b) Where chargeable income exceeds shs 10,000,000 an additional 10% is charged on income exceeding shs 10,000,000.

Compute PAYEE each worker

ADVANTAGES OF DIRECTOR TAXES

1. They are economical to collect by the government in that the government does not have to spend a lot of money to collect these taxes for instance in the P.A.Y.E system, the government simply deducts the tax from the tax payer`s salary.

2. **They are based on the principle of economic equity,** that is to the economic situation of persons determines the rate at which they are taxed. Also the progressive nature of direct taxation can help reduce income inequalities.
3. **Certainty of tax to be paid,** The tax payer is certain as to how much tax is to be paid, as the tax rates are decided in advance. The same implies for the government where it can estimate the tax revenue from direct taxes.
4. **Collection of direct taxes is generally economical.** Like in the case of personal income tax, the tax can be deducted at source (TDS) from the income or salaries of the individuals. So, the government does not have to spend much in tax collection as far as personal income tax is concerned.
5. **They are Relatively Elastic,** Increase in the income of individuals and companies, leads to increase in the yield from direct taxes also. An increase in tax rates would increase the tax revenues. Thereby, direct taxes are relatively elastic.
6. Direct taxes help control inflation. When the inflation is on the uptrend, the government increases the tax rate. With an increase in tax rate, the consumption and demand decline, which in turn help reduce inflation.
7. They redistribute income other than indirect taxes. This is because they are progressive in nature. This reduces on income inequality.
8. **They are convenient.** This is because they are collected at the time when the tax payers have earned enough funds e.g. the P.A.Y.E where payments are made in installments.
9. **They are progressive in nature hence they tend to be fair to the low income groups.** The progressiveness of a tax makes it equitable in the spreading of the tax burden i.e. it makes people to pay according to ability/taxable capacity.
10. They are easy and simple to understand by the tax payers and collect
11. They are flexible i.e. they can be increased or reduced depending on the requirements of the economy e. g. if the tax base reduces, the government can also lower the direct taxes.

Disadvantages of direct taxes

1. they are easy to evade, this is due to high tax rates, poor documentation and corrupt tax administration, by suppressing the correct information about incomes.

1. Direct taxes affect savings and investments. Due to tax implications, the net income of individuals reduces, in turn reducing their savings. This results in low investment, affecting the capital formation in the country.
2. **Arbitrary rate of taxation that** is there is no objective defined for determining the tax rates of direct taxes. Therefore, direct taxes may not always fulfill the requirement of equity.
3. **Inconvenient,** Direct taxes are inconvenient owing to the lengthy procedure of filing returns. For most people payment of direct tax is a task to convince oneself to pay a part of their income as tax to the state. This is a boost to evade tax further.
4. The cost of collection is at times high. This is because the government has to employ many officials and pay a lot to do the collection and administer direct taxes this they tend to be less productive.
5. They tend to discriminate among tax payers especially where tax assessment is not based on impartiality i.e. they do not have a wider coverage.
6. High rates of direct taxes make the people resent the government in power hence making

it popular.

7. They discourage entrepreneurship especially where the rates of corporate taxes are high.
8. Due to low taxable capacity in developing countries, little revenue is collected from direct taxes since majority of the people are poor where very few people earn above the threshold of income tax.

INDIRECT TAXES:

These are taxes levied on goods and services paid by an individual or business entity and shifted to the final consumer. These taxes are voluntary in the sense that one paysthem only when buy goods or consume services on which they are levied.

Forms/ types of indirect taxes

Customs Duty, this is a tariff or tax imposed on goods when transported across international borders. The purpose of it is to protect the country's economy, jobs by controlling the flow of goods, especially the restrictive and prohibited goods, in and out of the country. Hence, simply put, it is the tax imposed on imports and exports of goods.

NB: tax on imports is referred to as import duty while tax on exports is export duty.

Excise duty: Is a duty levied on commodities that are locally produced and consumed andPayable by the manufacturer who shifts the tax burden to retailers and wholesalers.

Sales tax: Is tax levied as a percentage of goods or services sold and paid by a shopkeeper or retailer, who then shifts the tax burden to customers by charging sales tax on goods and services.

Entertainment Tax: Liability is on the cinema owners, who transfer the burden to cinema goers

Service tax: a Charged on services rendered to consumers, such as food bill in a restaurant, hotels.

Value added tax (VAT)

Is an indirect tax that is paid by a person who consumes or imports goods and/or services in Uganda. The Tax is charged on the value added at different stages of production or supply of goods and services.

Main importance of VAT:

1. VAT completely avoids tax cascading as only charges tax on the Value Added.
2. VAT provide temporary financing for producers and service providers-by law, all VAT able persons are required to deduct the input VAT from the output VAT and remit the difference to the tax authorities monthly or every two months, so such organizations can utilize such funds to meet their working capital needs.
3. For the Government, VAT is a veritable source of revenue, its broad base, generates more revenue for the government; and secondly, its ease of collection (little or no cost) makes it more economical.
4. VAT serves as a fiscal policy instrument available to the government and used to increase or reduce VAT rate to redistribute income and check the consumption of harmful commodities such as cigarettes and alcohol.
5. VAT does not discourage production, or work since it is not a tax on income or profit, taxes on profits might actually discourage investments.
6. VAT is a powerful tool in harnessing funds in domestic markets enabling Uganda to better meet the challenges facing them such as education, poverty eradication, and provision of

infrastructure etc

7. VAT helps developing economies to be fully integrated in the international economy as being championed by IMF, World Bank of reducing government expenditure and increasing revenue etc.

Demerits of VAT

1. It's complicated to understand by the traders
2. It's difficult to assess
3. It based on evidence inform of records, this is very difficult to maintain
4. It discourages investment, as it reduces consumption and hence reduced market
5. It increases costs of production e.g. Vat on inputs
6. A high Vat rate makes government in power unpopular
7. It'seasily evaded as traders tend to different records

VAT CALCULATIONS

Computation of VAT occurs at two levels:

(a) VAT on a transaction i.e. a sale or a purchase

(b) VAT payable or claimable by the taxpayer other way put is VAT collectable or refundable by URA.

Key terms in VAT Computations

Output Tax, This is the VAT a taxable person charges upon making taxable supplies i.e. tax charged upon selling taxable goods and services.

Input Tax, This is the VAT a taxable person is charged on taxable purchases and expenses incurred for business purposes. The purchases could be from local sources or imported.

Taxable Supply

This is a supply of goods and/or services other than an exempt supply, by a taxable person for a consideration. A Taxable supply is charged to VAT at either zero rate or standard rate.

TAX RATE AND FRACTION

Tax rate

This is the percentage that is applied to the consideration for a transaction or taxable value, so as to determine the VAT amount. For example: if the consideration or taxable value is Shs 20, 000 and the VAT rate is 18% (18/100), then VAT = 20,000 x18/100

= Shs 3,600

Tax fraction

This refers torefers to the ratio used to determine the amount of VAT where the consideration is inclusive of VAT. The fraction is given by the formula: of VAT. The fraction is given by the formula:

R/r + 100

Where ris the VAT rate

Computation of VAT on a Transaction

VAT = Taxable value × VAT Rate(where taxable value excludes VAT) or

VAT = taxable value × VAT ratio(where the amount is VAT inclusive).

Illustration

If the rate of tax (r) = 18% then the tax fraction =18/(18+100) = 18/118.

For example if the consideration (VAT inclusive) is Shs20, 000, then VAT = 20,000 × 18/118 = Shs 3051.

Computation of VAT Payable or Refundable

VAT = output tax – input tax

Where output tax is greater than input tax, the taxpayer pays the difference. Where input tax is greater than the output tax, the taxpayer claims the difference.

(a) If output tax = 100,000 and input tax = 77,000 then VAT payable = 100,000 – 77,000 = 23,000

(b) If output tax = 100,000 and input tax = 140,000 then VAT claimable = 140,000 – 100,000 = 40,000

Examples

Mega enterprises had the following VAT exclusive transactions with VAT registered enterprises for one month

Purchases shs 236,000,000

Sales 259,600,000

Calculate the amount of VAT paid by mega enterprises to URA for that period(use 18% as vat rate)

Determine mega enterprises` total sales value vat inclusive

Solution

VAT =output tax –input tax

18/100 x 259,600,000- (18/100x 236,000,000)

Shs 46,728,000-42,480,000

Shs 4,248,000

Or

VAT = VAT RATE XVALUE ADDED

18/100(259,600,000-236,000,000)

18/100X 23,600,000

SHS4, 248,000

Total sales value (VAT INCLUSIVE)

=SALES VALUE +VAT on sales

259,600,000+ (18/100x 259,600,000

259,600,000 +46,728,000

Shs 306,328,000

Example 2

The following VAT exclusive transactions were availed by VAT registered business for the month of January 2018

Mark bought goods worth shs 60,000,000

Mark sold the same goods to Fred for shs 79,000,000

Fred sold the same goods to max a retailer for shs 90,000,000

Max sold the same goods to final consumer for shs 120,000,000

Determine the VAT chargeable for the value added at each stage

SOLUTION

VAT chargeable = VAT rate x value added

Stage 1 VAT chargeable = 18/100x60, 000,000

Shs 10,800,000

Stage 2 VAT chargeable= VAT rate x value added

18/100(790,000-60,000,000)

18/100x19, 000,000

Shs3, 420,000

Stage 3 VAT chargeable =VAT rate x value added

18/100(90,000,000-790,000,000

18/100x 11,000,000

Shs1, 980,000

Stage 4 VAT chargeable = vat rate x value added

18/100(120, 000, 00-90,000,000

18/100 x 30,000,000

Shs 5,400.000

The following VAT exclusive transactions were carried out by VAT registered business in February 2016 at different chains of distributions.

(i) Jero bought goods worth shs 9,000,000

(ii) Jero sold all the goods to Derrick for shs 11,000,000

(iii) Derrick sold the same goods to Jef the retailer for shs 14,000,000

(iv) Jef sold the goods to the final consumer for shs 19,000,000

Calculate the VAT chargeable at each stage using VAT rate of 18%.

(b) Advice entrepreneurs on the importance of paying taxes.

Advantages of indirect taxes

1. Indirect taxes are convenient to the government and tax payers. This is because they are collected when people have the money to spend on a product that a tax have been charged
2. They tend to contribute more to government revenue,this is because they are comprehensive i.e. they have a wider coverage and types.
3. They are economical to collect by the government since the government does not pay the traders who collect the taxes.
4. They are impartial in that they do not discriminate among tax payers thus the government is able to raise more revenue.
5. They are used to achieve economic stability especially by imposing high taxes on imported

goods so as to minimize import inflation.

6. The revenue yield is high.
7. They are used toprotect infant industries against unfair competition from efficient producers outside the country. This is done by imposing high tariffs on imports which make their prices relatively higher than domestic prices hence making them less competitive.
8. They are used to safe guard the health and morality of citizens. This can be done by imposing high taxes on goods likely to affect the health and morality of the citizens e.g. drugs, cosmetics, spirits etc. the high tariffs on such commodities make their prices prohibitively high hence resulting into few people who can afford them.
9. They are difficult to evade/ dodge because they are embedded in prices of commodities and these commodities must be brought at all costs ie during the buying of goods and services, taxes are paid.
10. They have a variety of taxes. This increases government revenue
11. They promote hard work among the tax payers. This is because in an attempt to meet the increasing prices of commodities and maintains the standard of living. People are forced to work hard so as to sustain their economic welfare.
12. Are flexible i.e. the tax rate can easily be adjusted depending on the desired objectives of the government.

Disadvantages of indirect taxes

1. They encourage trade mal-practices especially in foreign traders in an attempt to evade taxes through smuggling, under declaring the value of imports all of which have adverse effects on the economy.
2. Reduce economic welfare of citizens. This is because every product, there is a tax involved in form of increased prices.
3. They lead to increased costs of production, and this adversely affect the level of investment, production and employment levels within the economy i.e. they act as disincentives for investment.
4. Indirect taxes like import duties interfere with the freedom of trade hence reducing the volume of international trade.
5. Revenue from indirect taxes fluctuates a lot. This is because the amount of revenue collected depends on the volume of purchases or sales which normally fluctuates depending on prevailing season, economic situation etc. however; such fluctuations adversely affect planning based on projected revenue from taxes.
6. They spark off inflation. This is because they lead to increased costs of production which results into increased consumer prices.
7. When imposed on necessity goods, they become regressive. This is because necessities are consumed by both the rich and the poor in almost similar quantities e.g. sugar and if they are taxed indiscriminately the poor will be adversely be exploited
8. High indirect taxes cause consumers to change their consumption and expenditure patterns which may reduce their standards of living e.g. if the government imposes high taxes on beer**,** people may resort to the local brew.

DIFFERENCE BETWEEN DIRECT TAX AND INDIRECT TAX:

There are different implications of direct and indirect taxes on the country. However, both types of taxes are important for the government as taxes include the major part of revenue for the government.

Key differences between Direct and Indirect Tax are:

1. Direct tax is levied and paid for by individuals, Hindu undivided, firms and companies etc. whereas indirect tax is ultimately paid for by the end-consumer of goods and services.
2. The burden of tax cannot be shifted in case of direct taxes while burden can be shifted for indirect taxes.
3. Lack of administration in collection of direct taxes can make tax evasion possible, while indirect taxes cannot be evaded as the taxes are charged on goods and services in form of increases prices.
4. Direct tax helps in reducing inflation, whereas indirect tax enhances inflation as prices of raw materials increase.
5. Direct taxes have better a locative effects than indirect taxes as direct taxes put lesser burden over the collection of amount than indirect taxes, where collection is scattered across parties and consumers' preferences of goods is distorted from the price variations due to indirect taxes.
6. Direct taxes help in reducing inequalities and are considered to be progressive while indirect taxes enhance inequalities and are considered to be regressive.
7. Indirect taxes involve lesser administrative costs due to convenient and stable collections, while direct taxes have many exemptions and involve higher administrative costs.
8. Indirect taxes are oriented more towards growth as they discourage consumption and help enhance savings. Direct taxes, on the other hand, reduce savings and discourage investments.
9. Indirect taxes have a wider coverage as all members of the society are taxed through the sale of goods and services, while direct taxes are collected only from people in respective tax brackets.
10. Additional indirect taxes levied on harmful commodities such as cigarettes, alcohol etc. dissuades over-consumption, thereby helping the country in a social context.
11. Indirect taxes are defined according to the ability of the end taxpayer to shift the burden of taxes to someone else. While direct taxes allow the government to collect taxes directly from consumers.

EMPLOYEE'S RELIEF OR TAX EXEMPT

1. This refers to gains or income that is not included in the chargeable income of the employee and therefore not taxable on the employee:
2. The employee's income that is below the taxable threshold, currently at Shs 235,000 per month
3. Pension.
4. Discharge or reimbursement of medical expenses actually incurred by the employee.
5. Life insurance premiums paid by a taxable employer (company/individual) for the benefit of the employee.
6. Any non-cash benefit whose value is less than Shs 10,000 a month.
7. Relief of 25% on terminal benefits for employees who have served the employer for at least 10years.
8. Passage costs.
9. Employment income of an expatriate employee in a listed Institution, under a technical assistance agreement subject to the Minister's approval.
10. Official employment income of persons employed in the armed forces, Uganda Police Force and Uganda Prisons. It excludes persons serving there in civilian capacity.
11. Employment income of Ugandans posted to work in Ugandan diplomatic missions abroad.
12. Employment income of persons employed by EADB.

13. Allowances for members of Parliament
14. The Dividend received by resident company from another resident company where it controls more than 25% of the total share.
15. Furniture manufactured using local materials
16. Specialized furniture for use in Hospitals
17. The supply of unimproved land
18. Interest paid by a natural person or by a company to associated company or which is exempted from tax.
19. Beer produced from barley grown and malted in Uganda
20. The supply of unprocessed foodstuffs, including agricultural livestock,
21. Deposits in the bank

Employer's Obligation

1. To withhold taxfrom employment income, to deduct the correct tax from the employee's total employment income at the time of effecting payment to every liable employee.
2. To make Payment, to pay to URA the total tax by the 15th day of the month immediately following the month in which employment Income was paid.
3. To ensure accountability: to account for the tax deducted from every employee on a monthly basis to Uganda Revenue Authority.
4. To Maintain Employees' Records, and keep thoserecords for inspection by URA on demand for at least five years.

Employee`s obligation/rights

1. Employees should declare to their second employers that have the primary employer incomes from such employment
2. Declare total tax paid at source as payee
3. Tax payable

Employee`s rights

1. An employee is not required to furnish a return of income if their source of income is only from a single employer.
2. A tax payer is entitled to claim refund of overpaid tax where applicable.
3. A tax payer is entitled to accountability for all taxes deducted and paid at source by the employer.
4. A tax payer is entitled to prier information before any action is taken byURA.
5. A tax payer is entitled to equal treatment like any other tax payer.
6. A tax payer isentitled toconfidentiality from URA of personal tax information to be shared in public.
7. A tax payer is entitled to be attended to by URA officials regarding tax matters
8. A tax payer has a right to appeal over tax payment in case of need.

PROBLEMS OF TAXATION IN UGANDA
(Factors for the low tax base/ taxable capacity in Uganda)

Much as there is need for the government to levy taxes, the tax system in Uganda faces a lot of challenges that limit government tax revenue collection in the country. Such problems among others include the following:

1. Low levels of income individuals. The majority of the people in Uganda are poor due to low levels of economic activities in the country. Therefore, the government cannot raise more revenue due to low investment levels.
2. Presence of a small industrial sector. Most industries in Uganda are small scale leading to low profit margins. Consequently, tax revenue from corporate taxes is limited.
3. Presence of weak tax administrative machinery. The tax administrative system in Uganda is weak and this is reflected in dishonesty and incompetence of tax officials, low levels of integrity among tax collectors and assessors all of which account for the low tax yield.
4. Existence of a large informal sector. With limited book keeping, this results into under assessment which reduces the taxes collected and over assessment which reduces the tax resentment hence tax evasion and this reduces tax revenue.
5. High costs of collection and administration of taxes. This tends to reduce the tax revenue collected as more expenses are incurred in tax collection.
6. Existence of high rates of tax evasion and tax avoidance. This results into revenue shortages
7. Increased trade mal-practices. This takes inform of smuggling, under declaration of the value of imports and exports, over invoicing and under invoicing of goods and services all of which lead to low taxes.
8. Existence of high dependency ratio Uganda, where the majority of the people are not working and few people are engaged in production. This reduces the taxable income hence low revenue collecting.
9. The high of levels of unemployment and under employment in Uganda, this reduces the tax base and tax revenue.
10. Existence of a large subsistence sector. Uganda is characterized by low output coming out of predominant agricultural sector is largely for home consumption and not commercial use hence low tax revenue.

SOLUTIONS TO PROBLEMS OF TAXATION IN Uganda

1. Massive industrialization, to widen tax base, increase employment and income tax
2. Developing and encouraging use of labour intensive technology to reduce unemployment in most industrial firms, hence creating taxable income.
3. Carrying out sensitization to Minimize chances of tax evasion and tax avoidance.
4. Strengthening the functions of URA to reduce e trade mal-practices such as smuggling.
5. Training of tax collectors to improve on tax administration and penalizing or dismissing incompetent and dishonesty tax personnel.
6. Sensitization of tax payers about the importance of paying taxes. Through carrying out seminars, radio talks shows and community works.
7. Reducing human interaction to minimize corruption and increase efficiency in tax assessment .e.g. use of on line reporting.
8. Providing accountability of tax revenue by government. this increases the willingness of the tax taxpayer to pay the tax
9. Improving on infrastructure, to facilitate easy assessment and collection expenses.
10. Encouraging businessmen to keep records to avoid under assessment.

THE CONCEPT OF TAX EVASION AND AVOIDANCE

Tax avoidance

it involves the exploitation of loopholes and gaps in tax and other legislation in the tax system in to avoid paying taxes. Those loopholes may be in domestic tax law alone, or between domestic tax law and company law or between domestic tax law and accounting regulations, for example. The process can also seek to exploit gaps that exist between domestic tax law and the law of other countries when undertaking international transactions.

Tax evasion

Tax evasion is the illegal nonpayment or under-payment of taxes, usually resulting from the making of a false declaration or no declaration at all of taxes due to the relevant tax authorities, resulting in legal penalties (which may be civil or criminal) if the perpetrator of tax evasion is caught.

Forms of tax evasion and avoidance

1. Failure to report income and declaring sources of income.
2. Under-reporting income (claiming less income than you actually received from a specific source.
3. Providing false information to the tax authority about business income or expenses.
4. Deliberately underpaying taxes owed.
5. Understating taxes to be paid by tax payers.
6. **Failure to withhold tax and remit it to URA account.**
7. **Paying employees in cash**and failing to report some or all of these cash payments.
8. Filing false payroll tax reports.
9. Double recording of transactions with the intention of evading taxes.
10. Bribing tax collectors to make under assessment of taxes to be paid.
11. Smuggling of goods for the intention of evading taxes

TAX COMPLIANCE

The extent to which economic agents pay the taxes that their government has levied as stated by law.

Levels of tax compliance

The level of tax compliance depends on the tax payer`s attitude and knowledge. There are four levels of tax compliance which are as follows;

i. The tax payers fully comply to pay their taxes and willing to fulfill their obligations without being forced/voluntarily/molested.
ii. Tax payers know that non-compliance is expensive and they accordingly comply.
iii. Tax payers who show slight resistance to comply say it comes due to lack of knowledge. When tax payers are a little bit advised and some pressure is exerted/ put on them, they simply comply.
iv. Tax payers who are non-compliant show out right resistance when it comes to paying their taxes. This group includes some tax payers who become proud after failing to pay their taxes.

Factors influencing tax compliance in a country

1. The extent to which the tax system is equitable. The tax system which is fair encourages high level of compliance. On the other hand when the tax system is not fair, it discourages tax payers from paying especially when they feel that the distribution of tax burden is not fair.
2. The tax rates. High tax rates make taxation costly and this makes tax payers to avoid paying the taxes. Low tax rates encourage tax compliance.
3. The extent to which the tax laws are simple and easy to understand. Complicated tax laws and long administrative procedures make tax compliance to be low because long administrative processes encourage delays and disputes. On the other hand if the method of tax assessment and collection is simple, then people are encouraged to pay the taxes.
4. The extent to which tax burden is spread to all potential tax payers, where the burden of the tax is fairly distributed, an individual's find it easy to pay taxes and where tax holidays are given to some businesses, then those who not been granted tax holiday don`t comply.
5. The Popularity of government makes people not to pay. A government which is not popular and corrupt discourages people from complying. On the other hand a popular government without corruption encourages tax payers to comply.
6. Quality of business management, where business managers are unethical such that they don't keep records of accounts then tax compliance does not exist. But where the business managers practice business ethics by keeping records of accounts then tax compliance is possible.
7. Quality of tax administration; this depends on the level of integrity and customer care shown by the tax collector where the integrity of the tax collectors is good, then the payers comply and pay the taxes. But on the other hand where tax administration is poor in that the tax compliance does not exist.
8. The extent to which tax laws are consistent and fair, where the tax laws applied are inconsistent and unfair then the tax payers become non-compliant. On the other hand where the application of tax rules is fair encourages compliance.

9. The extent to which the system is convenient. This is from the principle of convenience which says that the place where to pay the tax has to be known by the tax payer, how much to be paid and when to pay have all be known by the tax payer where the place, the amount of tax and the time of paying tax are unknown then the taxpayers become non-compliant.

Manifestation of tax compliance

1. Timely filling of the required tax returns
2. Accurate reporting of income and tax liability
3. Timely payment of all tax obligations
4. Filing tax returns regularly
5. Settling tax liabilities promptly
6. Carrying out audit and providing audit report for tax assessment
7. Voluntarily registering for the tax
8. Keeping up-to-date books of accounts for tax
9. Complying with every tax laws of the country

Procedures for tax compliance

1. Registration of the tax payer with Uganda revenue authority
2. Obtaining the tax identification number

3. Preparation of tax records
4. Getting assessed for tax
5. Submitting timely tax returns
6. Payment of taxes
7. Receiving feedback from the tax authority

Causes of non tax compliance

1. Low levels of employment,
2. Inadequate knowledge about taxes
3. Loopholes within the tax system
4. Inadequate skilled staff to assess and collect taxes
5. Political sabotage
6. Desire by the employees to retain all their earnings
7. Inconvenient time for tax collection
8. Corruption and dishonest by the employee and employers
9. Poor methods of handling tax payers
10. High cost of living
11. Failure by government to remit taxes deducted from the employees

Measures to encourage tax compliance

1. Educating the employee on the need to pay taxes
2. Timely submission of tax returns to URA
3. Being honest in issues related to tax
4. Regularly issuing pay slips
5. Providing ways of how tax payers are able to understand laws related to tax
6. Reducing tax rates to encourage tax payers to pay
7. Ensuring that tax returns are properly posted
8. Informing the tax payers of the consequences of failing to comply by paying taxes in time

Consequences of non tax compliance/penalties of non tax compliance

1. Paying surcharge on all outstanding tax dues
2. Taking over management of the business by the tax authority
3. Closure of business
4. Taking court action leading to imprisonment
5. Auctioning business property to recover tax arrears
6. Publishing the business name in newspapers
7. Denying business to access contracts
8. Back listing the business

STRUCTURE OF UGANDA`S TAX SYSTEM

The structure of Uganda`s tax system is described by looking at the main aspects of country`s taxes. The major aspects include;

1. The body responsible for collecting taxes in Uganda is the Uganda Revenue Authority
2. The tax structure is madeup of two major departments. That is the inland department internal taxes and the custom department responsible for collecting taxes on imports and exports

3. The types taxes collected are basically direct and indirect taxes
4. The main sources of direct taxes are basically income tax, estateduty, capital gain tax,etc
5. The common indirect taxes are VAT, custom duty and excise duty
6. The nature taxes, most direct taxes are progressive in nature, that is to they increase as the tax payer`s income increases.
7. The purpose of taxation, it's basically to raise revenue for the government, other reasons include protecting infant industries and controlling consumption in the country.
8. New taxes are drafted by ministry of finance and discussed by parliament and implemented by URA

THE ROLE OF URA IN TAX ADMINISTRATION AND COLLECTION

The Uganda Revenue Authority is Uganda's' only tax body that was established by act of Parliament.

It is responsible for collecting taxes for national development in Uganda.

The taxes collected are both international and domestic taxes

The Uganda Revenue Authority is an independent institution that gets its mandate from the constitution of Uganda Article 153 of the constitution of Uganda 1995 as Amended which is to the effect that There shall be a Consolidated Fund into which shall be paid all revenues or other monies raised or received for the purpose of, or on behalf of, or in trust for the Government thus on that note it is salient to state that the Revenue Authority is solely responsible for the Collection of taxes in Uganda. It's responsible for collecting both domestic and international taxes

TAXES COLLECTED BY URA

1. Excise Duty
2. Excise Duty charged
3. licensing
4. Remission of excise duty
5. Returns and payments

   Non tax revenue
6. Stamp duty
7. Registration of motor vehicles
8. Transfer of ownership of motor vehicle

Role or responsibilities of URA

1. To advise government on matters related to taxes and tax policies
2. Assess and collect taxes e.g. domestic and foreign taxes
3. Account for taxes collected to parliament and ministry of finance
4. Provide policy frame to government relating to tax rates and administration
5. To protect the public against foreign and domestic fraud
6. Providing investment opportunities to both local and foreign entrepreneurs
7. Verify goods both import and export, this helps to avoid evading taxes
8. Recruit personnel for tax evaluation and implementation of tax policies
9. Providing avenue for tax payments e.g. encourage tax payers to have tax tin number and

tax accounts. This promotes accountability

10. Providing information related to taxes to the public, this is done through organizing seminars and workshops
11. Developing strategies of increasing tax base for the government,for example finding new tax base

CAUSES OF LOW TAX REVENUE

1. Low incomes, whichcannot be subjected to taxes
2. High levels of corruptions and embezzlement of tax bythe tax officials and other employees of government
3. Tax evasion ,many tax payers deliberately refuse to pay the taxes imposed ,thereby limiting the tax revenue collected
4. Limited development of the leading sectors of the economic sectors
5. High taxconcessions granted by the government to different investors, this reduces the tax revenue collected .such concessions include tax holidays, tax exempted etc
6. High cost of administrate ring and collecting the taxes, this reduces the tax revenue
7. Low tax rates, especially on the locally produced goods. This affects the revenue realized e.g. vat of 18%
8. Limited viable commercial activities, Uganda has a big subsistence sector compared to the commercial sector. hence producers produce mainly for their own consumption and less is put on the market for sale

Solutions

1. Developing and implementing strict tax laws
2. Training tax administrators on the ways of managing tax
3. Developing friendly laws
4. Massive investment
5. Reducing on the tax concession
6. Carrying seminars to educate tax payers on the importance of paying tax
7. Making accountability of tax payer`s money
8. Diversification of economic activities to include more tax bases
9. Improving of economic infrastructures ,to improve on tax collection and tax collection
10. Providing social services to the community

TERMS USED IN TAXATION

Tax base: Is any item or any economic activity that is to be taxed e.g. property, income, profit or any economic activity on which tax is paid.

Tax liability: This refers to the total amount of money a tax payer is expected to pay within a given period of time.

Taxable income: This refers to the income which is supposed to be taxed.

Taxable capacity: Refers to the extent to which an individual can pay taxes imposed on them without affecting his or her standard of living.

Threshold of the tax: Refers to the amount of money or level of income from which tax liability begins.

Impact of tax, this refers to final resting position of a tax that to say an entity or individual on which or whom the tax is imposed.

Incidence of tax: Refers to the person/ business that finally pay the tax imposed.

Tax yield: Refers to the total amount of tax revenue collected from a given number of taxes**.**

Average rate of tax: Refers to the proportion of income that is paid out as tax.

$$\textbf{Average rate of tax (VAT)} = \frac{\textbf{tax amount}}{\textbf{Total income}} \times 100$$

Marginal rate of tax: This refers to the proportion of additional income paid out as tax.

Tax evasion: Refers to the deliberate refusal by a tax paying unit to pay taxes levied on it.

Tax avoidance: This refers to a situation where a tax payer takes advantage of the loopholes/ weaknesses in the tax system so as to pay little tax as possible or pay no tax at all.

Tax holiday: Refers to the period of non tax payment given by the government to reduce consumers spending and encourage investment spending.

Forward shifting of a tax: This is when the money burden of the tax is shifted by a tax payer to another party who buys the output being taxed e.g. a manufacturer may shift the burden of tax to the wholesaler who then shifts it to the retailer and the retailer then shifts to the final consumer.

Back ward shifting of a tax: This is when the official taxpayer shifts the money (tax) burden of a tax to the person from whom he buys. For instance a producer using a given raw material may shift the money burden to the supplier of such a raw material. E.g. P.A.Y.E

Tax rebate: Refers to the refund made under specific circumstances

Capitalization of tax: A situation where a tax paying unit usually a firm artificially increase the value of its capital employed so as to reduce its tax liability.

Hidden tax: Refers to a tax paid on purchase of goods and services and usually included in the prices of the commodities being bought or taxed.

Tax haven: This refers to a situation where a country deliberately offers low tax rates or relaxed/ liberated tax laws so as to attract as much foreign investment and trade as possible.