

BUSINESS STUDIES NOTES

FORM 4 SIMPLIFIED VERSION

QUICK REVISION NOTES

*An Updated Well-Organized Detailed Revision Notes for the
Current Form 4 Syllabus.*

SERIES 1

THIS IS A FREE SAMPLE OF THE
ORIGINAL NOTES

CONTACT US FOR FULL VERSION OF THE NOTES

Mr Isaboke 0746 222 000

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Printed in Kenya

00100

Nairobi

0746-222-000

mwalimuconsultancy@gmail.com

Mwalimu Consultancy Ltd.

TOPIC 1:

SOURCE DOCUMENTS AND BOOKS OF ORIGINAL ENTRY

CONTENTS

- Source documents
- Books of original entry
- The petty cash book
- Analysis cash book

SOURCE DOCUMENTS

A source document is any document from which information recorded in the books of accounts is extracted.

Source documents serve as evidence that the transaction being recorded actually took place

Types of source documents

a) Cash receipt

This is a document that serves as evidence that cash has been received or paid out. Used as a source document when making entries in the cash books.

Normally prepared in duplicate. The original is issued to the person paying the money while a copy is retained by the receiver of the money.

A cash receipt may not be issued when payment is made by cheques since a cheque is in itself is a source document.

b) Invoice

An invoice acts as evidence that a credit transaction has taken place.

It is sent by the seller to the buyer demanding payment for goods supplied on credit.

An invoice is prepared in duplicate. A copy is retained by the sender

(Give an example of an invoice)

c) **Debit note**

This is a document sent by the seller to the buyer to inform him that the amount he owes the seller has been increased. It is used to correct undercharges in the invoice.

It is regarded as an additional invoice since it increases the amount already invoiced

(Give an example of a debit note)

d) **Credit note**

This is a document sent to buyer by the seller to inform him that the amount he owes the seller has been reduced. It therefore corrects overcharges in the invoice.

(Give an example)

e) **Payment voucher**

A document used as evidence of payment in cash. Used in circumstances where receipts cannot be issued e.g. in organisations with numerous workers. To be valid, it has to be signed by the person receiving the money.

f) **Statement of account**

This is a statement which is sent by a seller to a buyer to show the transactions which have taken place between them over a given period of time. It is intended to remind the buyer about the amount of money he owes the seller

BOOKS OF ORIGINAL ENTRY

These are books where transactions are recorded before being posted to the ledger

They are also known as subsidiary books, day books, books of prime entry, diaries or journals. In this topic, these books will be referred to as journals.

The act of recording information in these journals is known as journalizing

The main books of original entry include:

- The sales journal
- The sales returns journal
- The purchases journal
- The purchase returns journal
- Cash receipts journal
- Cash payments journal
- The general journal

Information recorded in these journals is obtained from the source documents discussed earlier

a) The sales journal

This journal is used to record only credit sales. When goods are sold on credit, an invoice is sent to the buyer to demand for payment. The invoice is therefore the source document.

Date	Details	Invoice number	Folio	Amount

(Illustration)

The information in the sales journal can be posted to the relevant ledger accounts

b) The sales returns journal

This journal is used to record the value of goods returned to the business by customers who had bought them on credit. When goods are returned to the seller, a credit note is sent to the buyer to reduce his indebtedness. The credit note therefore is the source document.

Date	Details	Credit note number	Folio	Amount

(Illustrations)

c) The purchases journal

This journal is used to record credit purchases. When goods are bought by the business on credit, an invoice is sent by the supplier to the business to demand for payment for the goods, this document becomes the source document for the purchases journal

Date	Details	Invoice number	Folio	Amount

(Illustration)

d) The purchase returns journal

This is a journal that is used to record the value of goods the business returns to its suppliers. When a business returns goods to its suppliers, its issued with a credit note to reduce its indebtedness, the credit note therefore becomes a source document for the purchase returns journal.

Date	Details	Credit note number	Folio	Amount

(Illustration)

e) The cash receipts journal

This is a journal that is used to record transactions which involve the flow of cash into the organisation. When cash is received by the business, a receipt is issued. The receipt therefore becomes the source document.

Date	Details	Receipt number	Folio	Discount allowed	Cash	Bank

f) Cash payments journal

This is a journal that is used to record transactions involving cash outflow from the business. When money is paid by the business, the cashier issues the receiver with a payment voucher, this voucher becomes the source document

Date	Details	Receipt number	Folio	Discount received	Cash	Bank

(Illustrations)

g) The general journal(journal proper)

This journal is used to record transactions involving non trading activities such as sale and purchase of fixed assets

Date	Details	Folio	Debit	Credit

Uses of the general journal

- Recording credit purchases and sales of fixed assets
- Correcting errors made in the ledger accounts
- Recording closing and opening entries of a business
- Recording the settlement of debts using fixed assets

- Recording transfer of debts
- It is used to record the issue of shares

(Illustrations)

Uses of journals

- To relieve the ledgers of too many details
- Journals provide more information than what is provided in ledgers therefore they can be used for reference
- They are prepared and maintained by different people hence minimizing the chances of errors and fraud
- They facilitate tracing of errors
- They contain information useful in preparing control accounts

Advantages of journals

- a) Helps one to know the account to be debited and credited
- b) Reduces the over use of ledgers
- c) They allow division of labour since they are prepared by different people
- d) They are used as a reference
- e) Minimizes fraud because they are prepared by different people

h) The petty cashbook

The word petty means small. Petty cash therefore refers to money set aside to be used in making payments that require little amounts of money; such as cleaning, postage, stationery etc.

As the business expands, number of transactions increases hence there is need to relieve the main cashbook of its bulkiness. To do this, a petty cashbook is opened to record transactions involving small payments.

The petty cashbook is under the responsibility of a special employee known as the petty cashier whereas the main cashbook is the responsibility of the general or main cashier. The money the petty cashier uses is obtained from the main or general cashier.

Receipts	L.F	Date	Details	Voucher number	Total	Analysis columns

The petty cashbook has two sides-the debit and the credit side. Receipts from the main cashier are recorded on the debit side while payments are recorded on the credit side. Payments are further recorded under the analysis columns

Analysis columns are normally given by the examiner. Any expense without an analysis column is recorded under miscellaneous

Petty cash book with the imprest system

The term imprest refers to the amount of money given to an officer in an organisation to spend on behalf of the organisation which he later accounts for.

The imprest system is where the money spent by the petty cashier after a specific period of time is refunded by the main cashier to restore the balance existing at the beginning of the period (cash float)

(Illustrations)

i) Analysis cash book

This is a cashbook that is used to analyse items of frequent occurrence

The analysis cash book has two sides-the debit and the credit sides. The debit side records all receipt while the credit side records all payments

(Illustration)

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TOPIC 2: FINANCIAL STATEMENTS

CONTENTS

- Introduction
- Concept of trading period
- Determination of profit or loss
- The balance sheet
- Basic financial ratios

INTRODUCTION

The purpose of any business is to make profit though at times, losses may arise. To determine the amount of profit/losses made, proper accounting records are prepared. These accounting records also enable the business to determine its financial position. These accounting records are known as financial statements.

Financial statements prepared by the business therefore include:

- The trading account
- The profit and loss account
- The balance sheet

THE CONCEPT OF THE TRADING (ACCOUNTING) PERIOD

The trading period refers to that period of time that elapses before a business calculates its profits/losses and determines its financial position. This period can be one month; two months etc. normally this period is 1 year for most businesses.

At the end of the trading period therefore, the following will take place

- All ledger accounts are balanced
- A trial balance is extracted
- Profits and losses are determined
- A balance sheet is prepared

DETERMINATION OF PROFIT OR LOSS

Businesses buy or produce the goods and services they sell. The price at which they buy or produce these goods is known as the cost price. The difference between the cost price and the selling price is the gross profit or gross loss. Profits/losses can be classified into two;

- Gross profit/loss
- Net profit/loss

a) Gross profits

Gross profit refers to the difference between the cost price and the selling price. When the cost price exceeds the selling, the difference is a loss but when the selling price exceeds the cost price, the difference is profit.

To determine gross profit, a statement known as a trading account is prepared.

THE TRADING ACCOUNT

This is a statement which is prepared to determine gross profit/loss. A trading account is therefore an account prepared at the end of the trading period in which gross profit or gross loss is prepared.

In the trading account, sales are recorded on the credit side while cost of sales is recorded on the debit side. The difference between the two is gross profit/loss.

To arrive at net sales and cost of sales, the following adjustments are made:

a) Returns inwards

These are goods that are returned to the business by customers to the business. They are also known as sales returns. Returns inwards are usually subtracted from sales to arrive at net sales.

b) Returns outwards

These are goods are returned by the business to the suppliers. They are also known as purchase returns. Returns outwards are subtracted from purchases to arrive at net purchases

c) Carriage inwards

This is the cost incurred in transporting goods to the business from the supplier. They are also called carriage on sales. Carriage inwards are regarded as part of purchases hence they are added to purchases when calculating gross profit or loss.

(Format and Illustrations)

Uses of the trading account

- Determines gross profit/loss
- Determines the cost of goods available for sale
- Aids in the calculation of margin and mark-up
- Aids in the calculation of the rate of stock turnover
- Determines cost of sales
- Reveals volume of sales
- Comparing performance between periods
- Facilitates the preparation of the profit and loss account

b) NET PROFIT OR NET LOSS

This is the difference between expenses and the sum of gross profit and revenue i.e.

Net profit/loss = gross profit + revenues – expenses

When expenses exceed the sum of gross profit and revenues, a net loss is made. But when expenses are less than the sum of gross profit and revenue, a net profit is made.

The profit and loss account

This is a statement which is used to determine net profit/loss. In the profit and loss account, gross profit and revenues are credited while expenses are debited. The balancing figure is the net profit/loss.

A gross loss is regarded as an expense and therefore is debited in the profit and loss account.

(Format and Illustrations)

TREATMENT OF SPECIAL ITEMS

a) *Bad debts*

The bad debts are subtracted from debtors or treated as a current liability in the balance sheet and treated as an expense in the profit and loss account

b) Depreciation

The amount of depreciation is subtracted from the respective asset in the balance sheet and treated as an expense in the profit and loss account

c) Provisions

On creation, they are subtracted from the respective item in the balance sheet and treated as an expense in the profit and loss account

On increase, the increase is deducted from the respective item in the balance sheet and treated as an expense in the profit and loss account

On decrease, the increase is added to cash in the balance sheet and treated as income in the profit and loss account.

Uses of the profit and loss account

- Shows the revenues earned and all the expenses incurred
- Determines net profit/loss
- Helps in calculating the amount of tax to be paid
- Helps employees to determine whether the business is in a position to pay them
- Enables lenders determine whether the business is able to pay them
- Used by managers and owners to make management decisions
- Aids in the calculation of the rate of return on capital and other profitability ratios

Trading profit and loss account

This is a statement that combines both the trading account and the profit and loss account. It is used to calculate both the gross profit/loss and the net profit/loss

(Illustrations)

THE BALANCE SHEET

A balance sheet is prepared after the trading profit and loss account has been prepared in order to show the financial position of the business. A “T” format is normally used when preparing the balance sheet.

Adjustments however have to be made on capital for the following items

- Net profit is added to capital
- Net loss is subtracted from capital
- Drawings are subtracted from capital
- Additional investments are added to capital

Types of capital

a) Capital owned(invested)

This is the owner's claim in the business. It is calculated as follows:

Capital owned = owner's contributions + profits – losses – drawings

b) Borrowed capital

This refers to other people's claims in the business. It is calculated as follows:

Borrowed capital = short term liabilities + long term liabilities

c) Working capital

Refers to the resources available in the business that can be used to immediate obligations. It is the excess of current assets over current liabilities

Working capital = current assets – current liabilities.

d) Capital employed

This refers to resources that have been generated from long term sources.

Capital employed = capital invested + long term liabilities

OR

Capital employed = total assets – current liabilities

OR

Capital employed = total fixed assets + working capital

(Illustrations)

Uses of a balance sheet

- Enables financiers to determine whether the business is able to meet their claims
- Shareholders use it to determine whether their funds are properly invested
- Helps the government for taxation purposes
- Shows the financial position of the business
- Determines the capital structure of the business
- Aids in the calculation of the rate of return on capital
- Potential investors use it to make decisions on whether to buy shares in the business
- Helps management in comparing performance between different periods
- Enables prospective business buyers make decisions on whether to buy the business.

BASIC FINANCIAL RATIOS

A ratio is an expression of one item in relation to another. Ratios are used to reflect the finer details of the financial status of the business; hence they are used for planning purposes

Basic financial ratios include:

- Mark-up
- Margin
- Current ratio/working capital ratio
- Rate of stock turnover
- Return on capital
- Acid test ratio/quick ratio

a) Mark-up

This is gross profit expressed as a fraction, a ratio or percentage of the cost price.

Mark-up = Gross profit ÷ cost of sales

(Illustration)

Mark-up helps the business determine satisfactory selling price that will yield enough gross profit that can cover all expenses and leave a reasonable net profit.

b) Margin

This is gross profit expressed as a ratio, fraction or percentage of sales.

Margin

= Gross profit ÷ Sales

Just

like mark-up, margin is also used to determine selling prices.

(Illustrations)

Uses of mark-up and margin

- Helps in setting selling prices of goods
- Can be used in the calculation of profits or losses
- Used in determining sales and cost of sales for a given period of time

Relationship between mark-up and margin

Since mark-up and margin relate to the same gross profit, it means they are related to one another. Therefore given margin, we can get mark-up and vice-versa. This is done by subtracting the numerator of margin from its denominator to get mark-up. For example if margin is $\frac{1}{4}$, mark-up will be $\frac{1}{4-1} = \frac{1}{3}$. Alternatively if mark-up is $\frac{1}{3}$, then margin is $\frac{1}{3+1} = \frac{1}{4}$

(Illustrations)

c) Current ratio/working capital ratio

Refers to current assets expressed as a ratio, fraction or percentage of current liabilities

Current ratio/working capital ratio = current assets ÷ current liabilities

Uses of current ratio

- Shows whether the business is in a position to meet its short term obligations when they fall due
- Helps in assessing whether the business is utilizing its resources fully

N/B: For the business to be in a position to meet its short term obligations, the current ratio should be more than 1

(Illustrations)

d) Rate of stock turnover(R.O.S.T.O)

The term turnover refers to the net sales

Rate of stock turnover also known as stock turnover ratio, refers to the speed at which stock is bought and sold within a given period in the business

It is calculated by dividing the cost of goods sold by the average stock

R.O.S.T.O = cost of goods sold ÷ average stock

AND

Average stock = (opening stock + closing stock) ÷ 2

Uses of rate of stock turnover

- Determines slow and fast moving stock
- Used to compute gross profit/loss

(Illustrations)

e) Return on capital

This is net profit expressed either as a fraction, ratio or percentage of capital invested.

Return on capital = Net profit ÷ capital invested

Uses of return on capital

- Compares performance of the business with others
- Compares the performance of the business between different periods
- Shows whether business finances are well invested
- Helps investors make decisions as to whether to invest

(Illustrations)

f) Acid test/quick ratio

It is given by

Acid test/quick ratio = (current assets – stock) ÷ current liabilities

This ratio enables the business determine whether it can meet its current liabilities as and when they fall due.

(Illustrations)

Importance of financial ratios

- a) They summarize numerous financial information in a form that can be understood
- b) They make the evaluation of the performance of the business easier
- c) They make it possible to determine trends and hence facilitate better management and investment decisions
- d) They facilitate the assessment of business efficiency
- e) They facilitate forecasting, planning and budgeting
- f) They reveal the strengths and weaknesses of the business to facilitate decision making

TOPIC 3: MONEY AND BANKING

CONTENTS

- Introduction
- barter trade
- money system
- banking

INTRODUCTION

Money: Money refers to anything that is generally accepted as a medium of exchange for goods and services. Money is in the form of notes and coins.

Banking: Banking refers to all activities carried out by financial institutions involving money. Financial institutions include the central bank, commercial banks and non-banking financial institutions.

BARTER TRADE

Barter trade is a system of trade where goods and services are exchanged with other goods and services. This is a system of trade that was used in African traditional societies though barter trade is still used in modern societies e.g. where a person works in exchange for food stuffs.

Merits of Barter trade

- Buyers and sellers are able to get immediately those goods and services they require
- Enables a country or person dispose off its surplus
- Promotes harmony, peace and understanding among trading partners
- Promotes specialization in production
- Promotes the standard of living of those involved in trade

Limitations of Barter trade

Despite the advantages mentioned above, barter trade has a number of drawbacks as discussed below

a) Requires double coincidence of wants

For barter trade to take place there must be double coincidence of wants. This means, that there must be somebody who has what you have and is in need of what you have for barter trade to take place. E.g. if someone has a goat and wants beans, then he has to look for someone who has beans and is in need of a goat. This situation is very difficult to come by.

b) Lack of standard measure of value

In barter trade, it is difficult to determine how much of a commodity should be exchanged for another. For example if someone has fish and is need of a cow, it will be difficult for him to determine the number of fish to exchange for one cow.

c) Indivisibility of some commodities

Some commodities cannot be subdivided into small quantities without loss of value. For example if you have a cow and you want one tin of maize, it will be difficult to subdivide a cow into smaller parts equivalent to one tin of maize.

d) Perishability of commodities

Some commodities will go bad before they reach the market resulting in losses to the seller.

e) Inconvenience in transporting some commodities

Some goods are too bulky to be carried from one place to another. This will greatly hinder trade.

f) Lack of standard of deferred payment

It is difficult to make payment in future using goods since their value could have reduced or needs of the person to be paid could have changed

g) Lack of unit of account

It is difficult to calculate the value of goods and keep a record for future reference

h) Hinders specialization

Lack of double coincidence of wants makes people produce as many products as possible in order to satisfy market demand

MONEY SYSTEM

Because of the many drawbacks, barter trade is no longer used; instead it has been replaced by money system of trade

Development of money

- a) The earliest form of money was commodity money which consisted of various commodities such as ivory, salt, beads, hides and skins. Commodity money had several limitations which include the following:
- Some commodities were perishable
 - Some commodities were not portable
 - Some commodities could be obtained easily without effort
 - Some commodities were indivisible
- b) Because of the above limitations, commodity money was replaced with metallic money which was in the form of copper, silver and gold. Metallic however had the following limitations:
- They were insecure to keep and carry around due to their high value
 - They were heavy to carry around
 - There were not easy to divide
- c) The above limitations led to the metallic money being replaced with paper money (paper notes) which was issued by goldsmiths and silversmiths who provided safe custody of precious metals. Paper money had the following limitations:
- Fake notes came into existence
 - Paper money lacking a legal force (backing by the law)
 - Lack of credibility of the issuing authority
- d) Paper money was followed by the development of legal tender currency notes and coins which had the backing of the law. Legal tender currency were issued in the form of bank notes and coins
- e) The need for convenience has given rise to representative and plastic money. Representative money are in form of cheques, money orders, bills of exchange etc. whereas plastic money is in the form of credit cards

Forms of money

- Commodity money
- Metallic money
- Paper notes
- Bank notes
- Coin money
- Bank deposits (money held in current accounts)
- Quasi money e.g. cheques, bill of exchange, credit cards, money orders, postal orders etc.

Characteristics of money

For any commodity to be accepted as money, it must have the following characteristics

a) Acceptability

Money must be generally accepted by everyone as a medium of exchange for goods and services

b) Divisibility

Money should be easy to subdivide into smaller units (Denominations) without losing its value.
This will enable people carry out transactions with ease.

c) Portability

Money should be light and not bulky in order to be carried around without difficulties.

d) Durability

Money should be able to stay for long without getting torn, defaced or losing its shape and texture.
The material used to make money should therefore be able to withstand tear and wear.

e) Stability

Money should be able to last for a long time without fluctuating in value.

f) Homogeneity

Money of the same denomination should be uniform in quality and therefore identical. This makes it more recognizable and hence acceptable

g) Cognisability

Money should be easy to recognize such that it is easy to differentiate between fake and genuine money.

h) Scarcity

Money should be relatively scarce in supply in order to retain its value. This is because if money is abundant in supply, it will lose its value greatly.

i) Malleability

The material used to make money especially coins should be easy to cast into different shapes

j) Not easy to forge

The material used to make money shouldn't be easily available. The technique used in making money should also be highly secretive in order to avoid forging

Functions of money

The following are the roles played by money in the economy

a) Medium of exchange

Money enables trade to take place as it is exchanged for various goods and services

b) Measure of value

Money provides a common denominator in which the value of various goods and services are expressed. For example 1kg of sugar is valued at Ksh 140.

c) Unit of account

Money provides a method through which the value of various commodities is calculated and a record kept. For example, land can be measured and its value recorded in terms of money.

d) Store of value

Money can be used as a means of storing wealth. This is done by saving money which can be used in the future to buy different commodities.

e) Standard of deferred payment

Money can be used to settle debts at any time because it is generally accepted as a medium of exchange for goods and services.

f) Transfer of immovable assets

Immovable assets can be sold and the money realized used to buy similar assets elsewhere.

Demand for money (liquidity preference)

Demand for money refers to the desire of people to hold on money without intending to spend it. This desire is influenced by three motives (reasons):

- The transaction motive
- Precautionary motive
- Speculative motive

a) The transaction motive

Refers to holding money in order to meet daily expenses such as buying food, paying for transport etc. one therefore has to ensure that he has money at all times to meet these daily expenses. Such moneys are held for transaction motives.

The amount of money held for transaction motive will depend on the following factors:

- **Individual level of income:** A person who earns more will have more money at his disposal hence he will hold more money to meet daily transactions as compared to someone with a low income
- **Interval between pay days:** When the interval between paydays is far apart, more money will be held unlike when the interval is short. For example, a person who is paid after a month need to hold more money to meet daily expenses for the whole month unlike a person who is paid daily.
- **Spending habits:** High spenders will hold more money as compared to low spenders. This is because they need more money to satisfy their spending habits
- **Prices of commodities:** When prices are high, people will require more money in order to meet their daily expenses unlike when prices are low
- **Availability of credit:** When people are not allowed to buy on credit, they will need more money to meet their daily expenses unlike when credit facilities are allowed

The transaction motive can further be subdivided into income motive and business motive. Income motive refers to holding money to spend on personal or family needs. Business motive refers to where money is held to meet business recurring needs such as paying wages.

b) The precautionary motive

This is where people tend to hold money to meet expenses that may occur unexpectedly. Such expenses may relate to sickness, accidents etc.

The amount of money held for precautionary purposes may depend on factors such as:

- **Level of income:** people with high levels of income tend to keep more money to cater against emergencies than people with low income levels
- **Family status:** high class individuals with high incomes tend to hold more money as a precautionary measure against emergencies as compared to low class individuals
- **Age:** older people are prone to health complications as compared to younger, they therefore need to keep more money to guard against emergencies
- **Number of dependants:** with more dependants, emergencies will be more hence more money has to be held to guard against these emergencies
- **Individual temperaments:** this has to do with how a person perceives life. An optimistic person will assume that nothing will go wrong in the future, such person will therefore keep little money to guard against emergencies as compared to a pessimistic person who assumes that many things will happen in the future
- **Interval between incomes:** when the interval between incomes is long, more money will be held to cater against as compared to when the interval between incomes is short

c) **The speculative motive**

This refers to holding money to spend in the future when economic conditions become favorable. For example an individual will keep his money in order to spend it in the future when prices are low

Amount of money held for speculative motive will depend on the following factors:

- **Levels of income:** the higher the income level, the higher the amount of money held
- **Individual temperaments:** an optimistic person who doesn't care the future happens will keep less money for speculative purposes as compared to a pessimistic person who is very conscious about the future.

Supply of money

Supply of money refers to the stock of monetary items in circulation at a given time. These monetary items may consist of

- Total currency in form of notes and account
- Total monetary deposits in commercial banks

Factors influencing the supply of money in the economy

- a) Central bank's monetary policy
- b) Ability of commercial banks to lend money to the public
- c) Ability of central bank to control the lending ability of commercial banks
- d) The rate of interest in the economy i.e. higher interest rates limits lending by commercial banks resulting in lower supply of money and vice versa
- e) The national budget i.e. the higher the national budget, the higher the supply of money and vice versa

BANKING

Banking refers to all the activities carried out by banks and other financial institutions involving money.

Development of banking

Banking developed from the services offered by goldsmiths and silversmiths. These services included:

- Accepting deposits of precious metals from the public
- Providing safe custody of the precious metals received

- Providing loans to traders from the deposits of precious metals held and charging interest on those loans
- Issued paper notes to the depositors which facilitated change of ownership of the precious metals deposited without having to withdraw the deposits

Many goldsmiths and silversmiths emerged to provide these services prompting governments to start controlling their activities. This led to the rise of banks and the need to control these banks led to the emergence of the central bank.

Banking system in Kenya consists of;

- The central bank
- Commercial banks
- Non-banking financial institutions

a) Commercial banks

These are banks which are formed with the main aim of making profit through financial intermediation. Their profits are made through:

- Interests earned on loans and overdrafts extended to customers
- Investments in the economy
- Income from daily operations e.g. ledger fees charged on customers' deposits

Examples of commercial banks in Kenya may include:

- Kenya commercial bank
- Family bank
- National bank of Kenya
- Standard chartered bank
- Co-operative bank of Kenya etc.

SERVICES OFFERED BY COMMERCIAL BANKS

a) Accepting deposits

Deposits constitute money kept in commercial banks by customers. By accepting deposits help people save their money. These deposits are accepted in three main accounts depending on the customers' desire namely

- Current account
- Savings account
- Time(fixed) deposit accounts

b) Lending money

Lending money refers to giving out money in form of loans. Commercial bank gives loans to individuals, businesses and government agencies. Such loans attract interest at given rates. These loans encourage investments in the economy leading to economic growth.

c) Safekeeping of valuable items

Commercial banks do accept some valuable items from their customers for safekeeping. Such valuable items may include title deeds, jewelry, wills etc. a fee is charged for safekeeping of these items.

d) Facilitating transfer of money

Commercial banks provide methods through which money can be transferred from one person to another. This is made effective using methods such as; cheques, standing orders, credit transfers etc.

e) Provision of foreign exchange

Commercial bank facilitates the exchange of different currencies. This is done to facilitate foreign trade. To offer foreign exchange services, commercial banks charge a fee.

f) Offering advisory services

Through their customer care services, commercial banks advise their customers on the available investment opportunities and on the best ways to manage their funds.

g) Provision of trustee services

Commercial banks can undertake to manage a deceased customer's property on behalf of the inheritors if requested by the customer. This is mostly done if by the time of death of the customer, inheritors were minors. The property is passed over to the inheritors when they attain maturity. To do this, the bank charges a fee.

h) Acting as guarantor or referee

Commercial banks may act guarantors to their customers who want to acquire goods on credit or borrow money from other financial institutions

i) Linking savers and borrowers

By accepting deposits and lending money in for of loans, commercial banks provide a forum through which savers and borrowers can interact

MONEY TRANSFER SERVICES

a) Standing order

This is an instruction to the bank from the account holder to be paying a given amount of money to a named person at given intervals for as specific period of time.

b) Credit transfer

This is method where one cheque is used to pay a given number of people whose account numbers and names are written on the cheques

c) Telegraphic transfer

This is a method of transferring money from one account holder to another. The sender fills an application form containing the details of the payee

d) Electronic funds transfer

This is a method of transferring money from one account holder to another via computers within the same bank or between different banks

e) Cheque

This is a written order by the account holder (drawer) to his bank to pay on demand a specified amount of money to the person named on its face (payee) or to the bearer.

f) Credit cards

These are cards which allows the customer to obtain goods and services from specified sellers without paying for them in cash. The value of the goods is deducted directly from the buyer's bank account and the money remitted to the seller

g) Travelers cheques

These are cheques which are issued to travelers in and out of the country to settle their debts in the country's they are visiting

COMMERCIAL BANK ACCOUNTS

Commercial banks accept deposits from their customers into three accounts;

- Current accounts
- Savings accounts
- Fixed(time) deposit accounts

a) Current accounts

This is an account where money can be deposited and be withdrawn at any time provided there is sufficient funds in the account

This account is suitable for business people who need money regularly

Its features

- Money is withdrawn at any time
- No minimum balance is required to be maintained in the account
- Account holders are allowed to use cheques to facilitate payments
- Money deposited in the account do not earn interest
- Customers can withdraw in excess of what is in their account. This excess withdrawal is known as an overdraft
- Deposits can be made at any time
- The bank charges ledger fees for maintaining the account
- The account holder is given periodical bank statements to show a summary of the transactions between him/her and the bank for a given period of time

Advantages of a current account

- They allow overdrafts
- Cheques can be used to effect withdrawals and make payments
- No minimum balance is to be maintained
- Regular bank statements are issued to the account holder
- Money can be deposited at any time
- Money can be withdrawn at any time

Disadvantages of current accounts

- No interest earned on deposits
- Ledger fees is charged to operate the account
- Withdrawals at any time discourages savings

b) Savings account

This is an account where money deposited is only withdrawn after a given period of time. Suitable for those who are interested in saving.

Its features

- Money deposited beyond a certain minimum earns interest
- Cheques are not used by the account holder to facilitate payment
- Overdrafts are not allowed

- A minimum balance has to be maintained in the account
- A notice must be served when withdrawing large amount of money exceeding a given limit
- Money is only withdrawn by the account holder himself
- Money can be deposited in the account at any time
- An initial deposit is required when opening the account

Advantages of a savings account

- Earns interest
- Low initial deposit
- Deposits can be made at any time
- Restrictions on withdrawals encourages savings
- Deposits can be made at anytime

Disadvantages of savings accounts

- A minimum balance is required to be maintained at all time
- A fee is charged when withdrawing
- Ledger fee is charged to operate the account
- Overdrafts are not allowed

c) Fixed(time) deposit account

This is an account where money deposited cannot be withdrawn until after the expiry of an agreed upon period. The period can be 3 months, 6 months, 1 year or 5 years. During this period no further deposits can be made.

This account suitable for people who have money that is not intended for immediate use.

Its features

- Earns interest at an agreed rate depending on the amount of money deposited and the duration
- There is a minimum amount of money that can be deposited in this account
- A deposit certificate is issued to the account holder to act as evidence of the contract
- If money is withdrawn before the expiry of the agreed period, no interest is earned
- At the expiry of the agreed upon period, all the money can be withdrawn together with the interest earned
- Involves large amounts of deposits
- Money is deposited in the account once
- The rate of interest is usually higher than in savings accounts
- There is a minimum amount of money that can be deposited in the account

Advantages of fixed deposit accounts

- Allow the account holder time to plan on how to spend the money deposited
- Deposited money can be used as a collateral security for a loan
- High interest is earned
- No ledger fees
- Encourages savings

Disadvantages of fixed deposit account

- A notice is given when terminating the account
- No interest if money is withdrawn before the expiry of the contract period
- Money deposited cannot be accessed before maturity of the period
- No regular deposits
- Minimum balance is high

Differences between fixed deposit accounts and savings accounts

<i>Fixed deposit accounts</i>	<i>Savings accounts</i>
Money is not withdrawn until the contract is over	Money is withdrawn after an agreed interval
Can be used as a security for a bank loan	Can be used as a security for a bank overdraft
The account remains in force for a specific period of time	The account is in force as long as the minimum balance is maintained
A large amount of money is required to open the account	A small amount of money is required to open the account
A separate account is required for each deposit	All deposits can be made in the same account
A certificate of deposit is issued once money is deposited in the account	A passbook or a bank card is issued when deposits are made into the account
Interest earned is high	Interest earned is low

Differences between savings accounts and current accounts

<i>Savings accounts</i>	<i>Current accounts</i>
Withdrawals are made after a specific period of time	Withdrawals are made at any time

A minimum balance must always be maintained in the account	No minimum balance is required to be maintained in the account
Cheques cannot be used to make payment	Cheques are used to make payment
Overdrafts are not allowed	Overdrafts are allowed
Interest is earned on the money deposited	No interest is earned on the money deposited
Large withdrawals require a notice to be given to the bank	Any amount of money can be withdrawn from the bank without a notice to the bank
Money remittance services are not permitted	Money remittance services are permitted

Reasons why majority of Kenyans do not operate bank accounts

- Most Kenyans earn low incomes which is entirely consumed hence no savings to keep in bank accounts
- Requirements to open bank accounts are not favourable to most Kenyans
- Instability in the banking sector discourages most Kenyans from operating bank accounts
- Ignorance of the existence of banking facilities by most Kenyans
- Banking facilities are located far away from some people

Ways in which commercial banks advance money to their customers

- Bank overdraft facilities
- Discounting bills of exchange and promissory notes
- Giving out personal loans

Disadvantages of a bank overdraft

- It may be expensive as interest charged is high
- Frequent use of overdraft by the business may be seen as a sign of mismanagement by financiers
- Banks may recall the overdraft at any time
- Overdrafts are not easily available unless one is well known or has a good reputation
- Overdrafts are only given to current account holders
- Overdrafts offer a limited amount of financing hence not suitable for long term financing
- Overdrafts require short repayment period which may affect the cash flow of the business

Reasons why commercial bank loans are not popular in Kenya

- High rate of interest is charged on the loans
- Individuals and firms may have cheaper sources of loans
- Not so many people have accounts with commercial banks
- Acquiring commercial bank loans involves a lengthy procedure
- Many people fear the consequences of failing to repay the loans
- Many people do not have recognized property to attach as collateral security

b) THE CENTRAL BANK

This is a financial institution which is established by the government of the country to manage and control the supply of and demand for money

Functions of the central bank

a) Issue of currency

The responsibility of issuing new currency lies with the central bank. The central bank will ensure adequate amount of money is in circulation. This is because excess money leads to inflation while too little money may suppress economic activities

b) Acts as a banker to commercial banks

The central bank offers banking services to the commercial banks. These banking services include:

- Maintains current accounts for commercial banks
- Receiving money deposits from commercial banks and providing safe custody of such deposits
- Facilitates the settlement of inter-bank debts
- Lends money to commercial banks
- Advises commercial banks on financial matters

c) Acts as a banker to the government

The central bank provides banking services to the government. These banking services include:

- Maintains current accounts for all government ministries and departments
- Receiving money deposits from the government and providing safe custody of such deposits
- Making payments on cheques drawn by the government
- Advising the government on financial matters
- Providing safe custody of funds received from abroad on behalf of the government

d) Controlling commercial banks

The central bank regulates the operations of commercial banks by giving them instructions on lending procedures and proper banking practices. This is done to prevent these commercial from exploiting their clients. Some of the methods used by central bank to regulate commercial banks include the following:

- Licensing commercial banks
- Inspecting commercial banks
- Approving the establishment of branches of commercial banks
- Ensuring the protection of depositors funds
- Punishing and closing down errant commercial banks
- Interpreting and implementing government monetary policies to all commercial banks

e) Links the country to external financial institutions

The central bank links the country with external financial institutions such as World Bank and the IMF. This facilitates healthy financial relationships enabling the country access financial assistance from such institutions

f) Maintaining stability in exchange rates

The central bank monitors the rates of exchange between the local currency and other currencies. It therefore comes up with methods of ensuring that stability in exchange rates is maintained at all time. This is done through the following methods:

- Devaluation of the local currency
- Ensuring that no commercial bank is allowed to effect payments abroad without seeking permission from the central bank
- Ensuring that no commercial bank is allowed to buy or sell foreign currency without seeking permission from the central bank
- Requiring commercial banks to submit periodic reports to the central bank showing their foreign exchange deals

g) Lender of last resort

The central bank can give loans to commercial banks. Commercial banks can therefore obtain loans from the central bank to meet their daily financial obligations when need arises

h) Facilitates clearing of cheques

Through the clearing house, the central bank facilitates the clearing of cheques between different commercial banks

i) Administering public debt

Public debt refers to all outstanding government borrowings both internal and external. The central bank is responsible for ensuring that such a debt is paid. The central bank therefore does the following:

- Sales government securities such as treasury bills and bonds to the public
- Discounts government securities
- Redeeming government securities on maturity
- Maintains a register of all government securities
- Paying accrued interest on government securities

j) Controlling monetary system

The central bank controls the supply of money in the economy. It does by using certain methods known as the instruments of monetary policy which will be discussed later.

The monetary policy

Monetary policy refers to the deliberate move by the government through the central bank to manipulate the supply, availability and cost of money in order to achieve the desired economic levels

Reasons for monetary policies

- To facilitate rapid and steady economic growth
- Create employment
- Stabilize prices of goods
- Ensure balanced economic development
- Ensure equilibrium in the balance of payments

TOOLS OF MONETARY POLICY

NOTE!

This is a Sample of the Well Organized Detailed Simplified Notes Available.

Call/Text/WhatsApp 0746-222-000 for the Complete Notes.

CONTACT MR ISABOKE

0746-222-000

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[*mwalimuconsultancy@gmail.com*](mailto:mwalimuconsultancy@gmail.com)

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