

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

ATC(U) EXAMINATIONS

LEVEL TWO

PRINCIPLES OF ACCOUNTING II - PAPER 5

TUESDAY, 17 JUNE 2008

INSTRUCTIONS TO CANDIDATES:

1. Time Allowed: **3 hours**
2. Attempt **all** questions in Sections **A** and **B**, any **two** questions in Section **C** and **one** question in Section **D**.
3. Section **A** has **twenty** compulsory multiple-choice questions each carrying 1 mark.
4. Section **B** has **one** compulsory question carrying 30 marks.
5. Section **C** has **three** questions and only **two** are to be attempted. Each question carries 20 marks.
6. Section **D** has **two** questions and only **one** is to be attempted. Each question carries 10 marks.
7. Please read further instructions in the answer book.

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SECTION A

Question 1

- (i) A debt instrument issued by a company is an example of:
 - (a) a financial asset.
 - (b) a liability.
 - (c) an investment.
 - (d) a loan to another company.
- (ii) Which of the following is **NOT** an investing activity under **IAS 7**: Cash Flow Statement?
 - (a) Payments to maintain a company lorry in its normal working condition.
 - (b) The cost of a new engine for a company lorry.
 - (c) A sale of a used company lorry.
 - (d) Dividend payments.
- (iii) The ratio of the company's current assets net of inventory and bad debts to current liabilities is known as:
 - (a) current ratio.
 - (b) acid test ratio.
 - (c) inventory to liability ratio.
 - (d) working capital ratio.
- (iv) Which of the following forms part of completed product cost in manufacturing accounts?
 - (a) Value of closing inventory of raw materials.
 - (b) Value of opening inventory of raw materials.
 - (c) Advertising cost for the manufactured goods.
 - (d) Delivery cost.
- (v) Dividend pay out ratio is:
 - (a) dividend per share divided by earnings per share.
 - (b) dividend per share divided by share price.
 - (c) dividends divided by earnings per share.
 - (d) proposed dividend plus interim dividend paid out.

- (vi) Which of the following is the best definition of net realizable value under **IAS 2: Inventories**?
- (a) The lower of factory cost and market price.
 - (b) The value calculated using first-in first-out (FIFO) method of valuation.
 - (c) The estimated selling price less estimated cost.
 - (d) The estimated selling price at arm's length less estimated cost of completion and any other necessary cost to make a sale.
- (vii) Which of the following meets the definition of cash and cash equivalent under **IAS 7: Cash Flow Statements**?
- (i) An investment whose maturity date is three months or less from the date of acquisition.
 - (ii) An investment whose maturity date is more than six months from the date of acquisition.
 - (iii) A loan repayable on demand only when it matures.
 - (iv) An investment which is highly liquid and readily convertible to cash.
- (a) (i) and (iii).
 - (b) (i) and (ii).
 - (c) (i) and (iv).
 - (d) (i), (ii) and (iv).
- (viii) The purpose of the realisation account in partnership accounting is to:
- (a) distribute partnership trading profits to partners.
 - (b) allocate assets to partners at the time of dissolution.
 - (c) determine profits or losses on the sale of assets and repayment of liabilities on dissolution of partnership business.
 - (d) determine profits or losses on the sale of assets at the time a partnership is dissolved.
- (ix) Which of the following gives the correct order of presentation of current assets in the balance sheet?
- (a) Inventories, receivables, cash balance and bank balance.
 - (b) Inventories, trade receivables, bank balances, cash balances and pre-paid expenses.
 - (c) Inventories, receivables, investments, bank balance and cash balance.
 - (d) Inventories, receivables, bank balance and cash balance.

- (x) The main purpose of preparing budgets for local governments is to:
- (a) control the past financial performance.
 - (b) ensure that local government activities are in line with previous performance.
 - (c) control the costs and implementation of local government projects.
 - (d) produce financial statements of local government.
- (xi) According to International Financial Reporting Standards (IFRS), companies are supposed to produce a complete set of financial statements. Which of the following combinations forms a complete set of financial statements?
- (i) Income statement.
 - (ii) Creditors reconciliation statement.
 - (iii) Balance sheet.
 - (iv) Bank reconciliation statement.
 - (v) Statement of changes in equity.
 - (vi) Budgets.
 - (vii) Notes to the financial statements.
 - (viii) Cash flow statement.
- (a) (i), (iii) and (viii).
 - (b) (i), (iii), (iv) and (viii).
 - (c) (i), (ii), (iii), (v), (vii) and (viii).
 - (d) (i), (iii), (v), (vii) and (viii).
- (xii) The net assets of non-profit organisations are financed by:
- (a) total assets.
 - (b) accumulated fund.
 - (c) share capital.
 - (d) excess income over expenses.
- (xiii) Under the realisation concept, profits or gains will be taken into account when:
- (a) goods or services are valued.
 - (b) replacement costs have been established.
 - (c) goods or services are provided by the seller.
 - (d) quotation is made.

- (xiv) Any amounts due from government on loans or guarantees are to be charged to the.
- (a) Consolidated fund.
 - (b) Exchequer.
 - (c) Treasury.
 - (d) Appropriations in aid.
- (xv) In consignment accounting, bad debts are paid by the agent only when:
- (a) commission is paid to the agent.
 - (b) extra commission is paid to the agent.
 - (c) customer agrees with the agent.
 - (d) the agent has enough money.
- (xvi) Goods are only said to be sold on consignment when the:
- (a) trader sends the goods to the customer directly under the agent's instructions.
 - (b) agent stores goods until they are sold by him.
 - (c) debts from customers are paid to the trader without the agent's knowledge.
 - (d) goods are sold to foreign customers only.
- (xvii) A bill of exchange is said to be retired when a:
- (a) rebate is allowed at settlement date.
 - (b) debtor fails to pay for the bill.
 - (c) bill is paid at maturity.
 - (d) bill is dishonoured.
- (xviii) When an owner of a business takes goods out of the business for personal use, the applicable accounting concept when accounting for the goods is referred to:
- (a) realisation.
 - (b) separate entity.
 - (c) prudence.
 - (d) money measurement.
- (xix) In financial accounting at any one time; $\text{Assets} = \text{Liabilities} + \text{Capital}$. Which accounting concept best applies to this formula?
- (a) Business entity.
 - (b) Dual aspect.
 - (c) Money measurement.
 - (d) Cost.

- (xx) Which of the following expenditures incurred by a business entity will **NOT** appear in the income statement?
- (a) Interest from partner's loan account.
 - (b) Salary paid to temporary staff.
 - (c) Money used to maintain a personal car.
 - (d) Insurance.

SECTION B

Question 2

Farshal Ltd is an engineering company with many large departments each making separate products. The information given below relates to periods of 2006 and 2007.

Balance Sheet as at 30 September

	2006 Shs '000	2007 Shs '000		2006 Shs '000	2007 Shs '000
Equity share capital	60,000	65,000	Goodwill	6,000	4,000
General reserves	10,000	11,200	Machinery	17,000	22,950
Payables	6,500	6,220	Furniture	13,500	10,800
Accrued expenses	200	380	Inventory	29,000	31,100
Provision for taxation	8,000	9,000	Receivables	8,000	8,300
Proposed dividend	6,600	7,800	Cash in hand	300	400
			Cash at bank	7,500	11,300
			Pre-paid expenses	-	250
			Advance payment		
			of income tax	8,000	9,500
	-	-	Preliminary expenditure	2,000	1,000
	<u>91,300</u>	<u>99,600</u>		<u>91,300</u>	<u>99,600</u>

Income statement for the year ended 30 September 2007:

	Shs '000'
Turn over	189,300
Cost of sales	<u>124,300</u>
Gross profit	65,000
Less operating expenses (Note 1)	<u>56,000</u>
Net profit	9,000
Transfer to general reserves	1,200
Proposed dividends	<u>7,800</u>
	<u>0</u>

Notes

1. Operating expenses include:

	Shs '000'
Rent	15,000
Salaries	21,400
Electricity	1,000
Petty cash expenses	950
Loss on disposal of furniture	400
Depreciation on -machinery	4,050
-furniture	1,200
Goodwill written off	2,000
Preliminary expenses written off	1,000
Provision for income tax	<u>9,000</u>
	<u>56,000</u>

2. During the period, furniture with book value of Shs 1,500,000 was sold for Shs, 1,100,000 and new machinery costing Shs 10 million was purchased.
3. New equity shares were allotted at par for Shs 5 million.
4. Taxation liability for the accounting period 2005 to 2006 was settled at Shs 8 million, the amount having already been paid. For the period 2006 to 2007 an advance tax of Shs 9,500,000 was paid.
5. During the period, dividend for the period 2005 to 2006 was paid.

Required:

Prepare a cash flow statement for the period ended 30 September 2007 in accordance with **IAS 7**: Cash Flow Statement.

(30 marks)

SECTION C**Question 3**

Hot, Warm and Cool have been in partnership for several years sharing profits and losses in the ratio 3:2:1 respectively. The partnership's account balances as 31 October 2007 were as follows:

	Shs million	Shs million
Fixed assets at cost	20,000	
Inventory	5,000	
Trade receivables	21,000	
Accumulated depreciation		6,000
Bank		13,000
Trade payables		17,000
Capital: Hot		4,000
Warm		4,000
Cool	-	2,000
	<u>46,000</u>	<u>46,000</u>

Additional information:

Recently, a major credit customer of the business became insolvent at a point when he owed Shs 18 billion to the partnership. This setback greatly affected the continuity of the partnership business and thus the partners agreed to dissolve the partnership on the following terms:

- (i) Inventory was to be sold to Plastic Ltd, a competitor, at Shs 7.5 billion.
- (ii) Fixed assets were to be taken over by Cool at a cost of Shs 10 billion.
- (iii) Trade debtors, except for the insolvent customer, accepted to pay their accounts in full.
- (iv) Dissolution costs were shs 800 million, discounts received from trade creditors were Shs 500 million.
- (v) Cool was unable to meet his liability to partnership.

Required:

- (a) Prepare the realisation account.
(6 marks)
- (b) Prepare capital accounts to record the dissolution of the partnership.
(9 marks)
- (c) Briefly explain the term 'dissolution' and give reasons for partnership dissolution.
(5 marks)

(Total 20 marks)

Question 4

- (a) The following are financial statement extracts of Nile Manufacturing Co. Ltd (NMCL) for the period ended 30 December 2007:

Income Statement Extract

	2006	2007
	Shs '000	Shs '000
Turn over	506,000	450,000
Purchases	150,000	120,000
Profit after interest and tax	74,000	30,000

Balance Sheet Extract

	2006	2007
	Shs '000	Shs '000
Non-current assets	670,000	500,000
Current assets	130,000	120,000
Current liabilities	112,000	112,000

Additional information:

The balance of inventory in the books were as follows:

	2006	2007
	Shs '000	Shs '000
Opening inventory	46,000	42,000
Closing inventory	87,000	60,000

Required:

Compute the following ratios:

- (a)
- | | |
|---------------------------|-----------|
| (i) Net margin | (2 marks) |
| (ii) Gross margin | (2 marks) |
| (iii) Turnover | (2 marks) |
| (iv) Return on investment | (2 marks) |
- (b) In the books of TAC Ltd, the cost of the inventory on hand on 30 April 2007 was Shs 50,500,000. During May 2007, the management of TAC Ltd was doubtful of the realisable value of inventory and therefore a sample of 20% of the inventory was subjected to a thorough check. It was found that out of the sample:
- (i) 80% was good and was expected to realize the selling price of cost plus 20%.
- (ii) 15% was slightly damaged and required an expenditure of 10% of the sale value for making it readily saleable at the normal selling price.

- (iii) 5% was so damaged and thus unfit for normal sale. It would fetch only 50% of the normal selling price.

Required:

What is the value that can legitimately be attached to the closing inventory on 30 June 2007?

(12 marks)
(Total 20 marks)

Question 5

Owino Local Council prepared a revenue budget for the financial period 2006 – 2007 in respect of revenue head 150 – 080 miscellaneous taxes as follows:

Item No.	Description	Budget Shs million
00820	Hotel accommodation fees	750
00821	Entertainment tax	155
00822	Betting / casino tax	75
00823	Trading licences	520
00840	Stamp duty	170
00845	Other revenues	56

During the period, an analysis of the records was made and it was discovered that collection / revenues for the period were as follows:

Item No.	Description	Budget Shs million
00822	Betting / casino tax	130
00821	Entertainment tax	145
00823	Trading licences	500
00840	Stamp duty	168
00820	Hotel accommodation fees	155
00845	Other revenues	157

Additional information:

The revenue collected in 2005 – 2006 but not paid to the exchequer as at 30 June 2006 amount to Shs 65,500,000 and balance of revenue on hand as at end of 2006 – 2007 period was Shs 1,697,200.

Required:

Prepare a revenue statement for the period 2006 – 2007 indicating the amount to be paid to the exchequer and showing all variances.

(20 marks)

SECTION D

Question 6

Briefly explain **five** functions of the Local Government Finance Commission.

(10 marks)

Question 7

Briefly explain the following terms:

- (a) Dishonoured bills. **(2 marks)**
- (b) Retired bills. **(2 marks)**
- (c) Del credere commission. **(2 marks)**
- (d) Discounts allowed. **(2 marks)**
- (e) Accumulated fund. **(2 marks)**

(Total 10 marks)