

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

ATC(U) EXAMINATIONS

LEVEL TWO

PRINCIPLES OF ACCOUNTING II – PAPER 5

MONDAY, 28 NOVEMBER 2011

INSTRUCTIONS TO CANDIDATES

1. Time allowed: **3 hours 15 minutes**.

The first 15 minutes of this examination have been designated for reading time. You may not start to write your answer during this time.

2. Attempt all questions in Sections **A** and **B**, any **two** questions from Section **C** and any **one** from 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 on the answer book, before attempting any question.

SECTION A

Question 1

- (i) Which of the following accounting concepts determines the right to receive revenue and the obligation to pay for expenses?
- (a) Realization.
 - (b) Accrual.
 - (c) Cost.
 - (d) Periodicity.
- (ii) Which of the following does **NOT** relate to an accounting convention?
- (a) Consistency.
 - (b) Adequate disclosure.
 - (c) Materiality.
 - (d) Accrual.
- (iii) Which of the following statements are correct?
- (i) A company might make a rights issue if it wishes to raise more equity capital.
 - (ii) A rights issue might increase the share premium account whereas a bonus issue is likely to reduce it.
 - (iii) A bonus issue reduces the gearing (leverage) ratio of a company.
 - (iv) A rights issue always increases the number of shareholders in a company whereas a bonus issue does not.
- (a) (i) and (ii).
 - (b) (i) and (iii).
 - (c) (ii) and (iii).
 - (d) (ii) and (iv).
- (iv) In case of fixed capital accounts, partners' salaries are:
- (a) credited to their capital accounts.
 - (b) debited to their current accounts.
 - (c) debited to their capital accounts.
 - (d) credited to their current accounts.
- (v) Which of the following does **NOT** necessarily lead to dissolution of a partnership?
- (a) Expiry of the term of duration.
 - (b) Insolvency of a partner.
 - (c) Admission of a new partner.
 - (d) Retirement of a partner.

- (vi) Which of the following elements of cost does **NOT** appear in the manufacturing statement?
- (a) Cost of materials.
 - (b) Indirect labour.
 - (c) Factory overheads.
 - (d) Auditing fees.
- (vii) Under what circumstances can a manufacturing loss occur?
- (a) When the factory is very efficient and produces goods at prices higher than what is offered on the market.
 - (b) When the factory is inefficient and produces goods at prices lower than what is offered on the market.
 - (c) When the factory is inefficient and it is better to buy goods from outside which are cheaper.
 - (d) When the company is a monopoly.
- (viii) Which of the following is a production cost under manufacturing accounts?
- (a) Depreciation charge for raw materials' warehouse.
 - (b) Cost of advertising finished products.
 - (c) Bonuses paid to sales personnel.
 - (d) Depreciation charge for sales' showroom fixtures.
- (ix) is an instrument in writing containing an unconditional undertaking signed by the banker to pay a certain sum of money only to, or to the order of, a certain person.
- (a) A bill of exchange
 - (b) A promissory note
 - (c) A cheque
 - (d) An accommodation bill
- (x) Which of the following statements is **FALSE** about the issue of shares at a premium?
- (a) The bank account is debited with the total amount of money received on application.
 - (b) Ordinary share application account is debited with ordinary share capital and share premium.
 - (c) The share premium account is debited with the difference between the par value and the value at which the shares are issued.
 - (d) The ordinary share capital account is credited with the par value of the shares issued.

- (xi) Which of the following formulae represents the capital gearing ratio?
- (a) $\frac{\text{Long-term debt} + \text{preference shares}}{\text{Shareholders equity}}$.
 - (b) $\frac{\text{Shareholders equity}}{\text{Long-term debt} + \text{preference shares}}$.
 - (c) $\frac{\text{Long-term debt} + \text{preference shares}}{\text{Shareholders equity} + \text{long-term debt}}$.
 - (d) $\frac{\text{Shareholders Equity} + \text{long-term debt}}{\text{Long-term debt} + \text{preference shares}}$.
- (xii) The following statements are true about consignment accounts **EXCEPT**:
- (a) a consignee is a person who dispatches goods to the consignor and bears the risk.
 - (b) a consignor dispatches the goods to the consignee to be sold at the risk of the consignor.
 - (c) the sale proceeds of the consigned goods belong to the consignor.
 - (d) the consignee gets a commission in addition to any expenses he may have incurred.
- (xiii) Under IAS 7: Statement of Cash Flows, cash equivalent comprises of:
- (a) demand deposit and highly liquid assets of the entity.
 - (b) highly liquid investments that are readily convertible to known amounts of cash subject to insignificant risk of change in value.
 - (c) the current and highly liquid assets of the entity.
 - (d) short term investments that are readily convertible to known amounts of cash which are subject to significant risk of changes in value.
- (xiv) Under IAS 7: Statement of Cash Flows, the following are financing activities **EXCEPT** cash:
- (a) proceeds from issue of shares.
 - (b) payable to owners to redeem or acquire the entity's shares.
 - (c) receipts and payment for contracts held for trading purposes.
 - (d) repayments of amounts borrowed.
- (xv) In consignment accounts, *del credere* commission is allowed to the consignee to bear:
- (a) normal loss.
 - (b) abnormal loss.
 - (c) sales in excess of a specific amount.
 - (d) loss on account of bad debts.

- (xvi) Which of the following ratios is **NOT** an activity ratio?
- (a) Gross profit ratio.
 - (b) Total capital turnover ratio.
 - (c) Inventory turnover ratio.
 - (d) Trade receivables turnover ratio.
- (xvii) The acid-test ratio is calculated as:
- (a) $\frac{\text{quick assets}}{\text{current liabilities}}$.
 - (b) $\frac{\text{fixed assets}}{\text{current assets}}$.
 - (c) $\frac{\text{current assets}}{\text{current liabilities}}$.
 - (d) $\frac{\text{current liabilities} - \text{inventory}}{\text{current assets}}$.
- (xviii) The adjustment of approved funds between employee costs and other charges under different programmes of expenditure is referred to as:
- (a) virement.
 - (b) relocation.
 - (c) supplementary.
 - (d) vote on account.
- (xix) Local government revenue estimates can be classified as any of the following **EXCEPT**:
- (a) local revenue.
 - (b) government transfers.
 - (c) programme revenue.
 - (d) donor funds and NGOs.
- (xx) Agency accounts of local governments include the following accounts **EXCEPT**:
- (a) works.
 - (b) referral hospital.
 - (c) delegated staff salaries.
 - (d) medical training schools.

SECTION B**Question 2**

The following trial balance was extracted from the books of Potea Ltd as at 31 October 2011:

	Dr	Cr
	Shs '000'	Shs '000'
Preference share capital: Shs 1,000 per share		100,000
Ordinary share capital: Shs 500 per share		120,000
General reserve		90,000
Exchange reserve		27,200
Accumulated profits 1 November 2010		38,686
Inventory 1 November 2010	214,286	
Sales		898,220
Returns inwards	22,760	
Purchases	437,880	
Carriage inwards	4,950	
Wages (putting goods in saleable condition)	6,192	
Wages: warehouse staff	79,444	
Wages & salaries (sales staff)	56,322	
Wages & salaries (administration staff)	69,556	
Motor vehicle expenses (note ii below)	32,800	
General distribution expenses	16,122	
General administration expenses	15,828	
Debenture interest	20,000	
Royalties receivable		8,358
Directors' remuneration	36,900	
Bad debts	6,100	
Discounts allowed	10,328	
Discounts received		8,184
Plant and machinery at cost	350,000	
Provision for depreciation: plant and machinery		116,800
Motor vehicles at cost	64,000	
Provision for depreciation: motor vehicles		29,000
Goodwill	59,000	
Development cost	32,640	
Trade receivables	156,210	
Trade payables		74,212
Bank overdraft		8,558
Bill of exchange payable within 1 year		12,100
Debentures		160,000
	<u>1,691,318</u>	<u>1,691,318</u>

Additional information:

- (i) Inventory on 31 October 2011 was valued at Shs 280,162,000.
- (ii) Motor vehicle expenses and depreciation on motor vehicles to be apportioned: distribution 75% and administration 25%.
- (iii) Plant and machinery depreciation to be apportioned as: cost of sales 20%, distribution 60% and administration 20%.
- (iv) Depreciate the following fixed assets on cost:
Motor vehicles 25%.
Plant and machinery 20%.
- (v) Provide for corporation tax on the profit for the year Shs 28.3 million payable by 30 July 2012.
- (vi) Preference dividend of Shs 10 million is to be paid and ordinary dividend of Shs 20 million to be proposed.

Required:

Prepare, for Potea Ltd, for the year ended 31 October 2011 for internal use, a statement of:

- (a) comprehensive income. **(18 marks)**
- (b) financial position. **(12 marks)**

(Total 30 marks)

SECTION C**Question 3**

- (a) Explain **six** situations that may give rise to non-purchased goodwill. **(6 marks)**
- (b) On 1 November 2010 Wangare owned a business in which he had Shs 20 million capital. As from 1 May 2011 Giboyi came in as a partner on the following terms:
 - (i) Wangare's capital was to remain unchanged and Giboyi was to bring in Shs 12.3 million of which shs 5,000,000 was to be credited to his current account.
 - (ii) Interest at 5% was to be allowed on capital from the start of the partnership,
 - (iii) Giboyi was to be credited with a salary of shs 7,000,000 per annum.
 - (iv) Profits, after charging interest and salary, were to be divided Wangare 2/3 and Giboyi 1/3.
 - (v) Giboyi withdrew Shs 4,500,000 on 1 June 2011, Shs 3,250,000 on 31 July 2011 and Shs 3,250,000 on 30 September 2011.
 - (vi) At 30 November 2011, the net profit available for division before charging the partnership interest and salary was Shs 1,485,000.

Required:

Prepare the partnership appropriation account, current accounts and capital accounts for the partners.

(14 marks)
(Total 20 marks)

Question 4

Mr. Okumu is a sole proprietor of a shoe manufacturing business. The following trial balance was extracted from his books as at 30 September 2011.

	Dr	Cr
	Shs '000'	Shs '000'
Capital		244,800
Freehold land & building (at cost)	180,000	
Plant and machinery (at cost)	174,000	
Provision for depreciation: Plant and machinery		84,000
Salesmen's motor vehicles (at cost)	48,000	
Provision for depreciation – salesmen's motor vehicles		33,600
Loose tools at valuation 1 October 2010	14,400	
Inventory 1 October 2010: Raw materials	39,600	
Finished goods	72,000	
Purchases : Raw materials	222,000	
Loose tools	9,600	
Sales		792,000
Wages and salaries : Factory	163,600	
Administration	64,800	
Sales department	36,000	
Rates and insurance	19,200	
Repairs and maintenance	12,000	
Sales expenses including motor vehicles running costs	17,200	
Electricity and power	72,000	
Industrial training levy	3,600	
Administration expenses	33,600	
Provision for doubtful debts		12,000
Trade receivables and payables	99,200	96,400
Drawings	24,000	
Bank		43,200
Cash in hand	1,200	
	<u>1,306,000</u>	<u>1,306,000</u>

Additional information:

- (i) Closing inventory as at 30 September 2011:
 - Raw materials Shs 33.6 million
 - Finished goods Shs 66.8 million
 - Loose tools at valuation Shs 19.2 million.
- (ii) Provisions to be made for the following amounts owing on 30 September 2011:
 - Electricity and power Shs 9.6 million.
 - New machinery Shs 30 million.
- (iii) Payments in advance on 30 September 2011 were as follows:
 - Motor vehicles licenses Shs 126,000
 - Rates Shs 690,000.
- (iv) Depreciation on plant and machinery and salesmen's vehicles is to be provided at the rate of 20% and 25% respectively on cost at the end of the year.
- (v) Bad debts amounting to Shs 1.3 million are to be written off and the provision for doubtful debts to be made at 10% of trade receivables.
- (vi) The following expenses to be apportioned two thirds to factory and one third to administration: electricity and power, repairs and maintenance and insurance.

Required:

Prepare, for Okumu, for the year ended 30 September 2011 a:

- (a) manufacturing statement. (10 marks)
 - (b) statement of comprehensive income. (10 marks)
- (Total 20 marks)**

Question 5

- (a) Write short notes on each of the following in relation to the Local Government Financial and Accounting Regulations:
 - (i) Vote on account.
 - (ii) Virement warrant.
 - (iii) Supplementary estimates.
- (6 marks)**

- (b) The following information was extracted from the books of the newly created Mawazo District Local Government for the financial year ended 30 June 2011:

	Shs '000'
Land and buildings	200,000
Vehicles	120,000
Work-in-progress	60,000
Investments	30,000
Cash and bank balances	10,000
Advances	18,000
Sundry receivables	66,000
Pre-payments	25,000
Bank overdraft	40,000
Sundry payables	70,000
Grants	450,000
Loans	250,000

Required:

Prepare a memorandum statement of financial position as at 30 June 2011 for Mawazo District Local Council under:

- (i) Cash basis. (6 marks)
 (ii) Accrual basis. (8 marks)

(Total 20 marks)

SECTION D

Question 6

Promissory notes, bills of exchange and cheques, are negotiable instruments. This means the holder can claim money on them.

Required:

Explain **five** differences between a cheque and a bill of exchange.

(10 marks)

Question 7

IAS 7: Statement of Cash Flows, requires cash flow statements to be presented under the following headings:

Cash flows from operating activities, cash flows from investing activities and cash flows from financing activities.

Required:

Briefly explain **three** examples of items that would be listed under each of the above headings.

(10 marks)