MACHAKOS UNIVERSITY

University Examinations for 2020/2021 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING BANKING AND FINANCE

SECOND YEAR SPECIAL/ SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF COMMERCE

BAC 201: ACCOUNTING FOR LIABILITIES AND EQUITIES

DATE: 26/3/2021 **TIME: 8.30-10.30 AM**

INSTRUCTIONS:

Answer question one and any other two questions.

QUESTION ONE (COMPULSORY) (30 MARKS)

a) Briefly explain why each of the following is classified as a current liability;

i. Corporate tax payable

ii. Notes payable

iii. Interest payable

iv. Bills payable

v. Warranties Payable (10 marks)

b) ABC Corporation is considering two plans for financing the construction of a new Shs.5,000,000 plant. Plan A involves issuance of 200,000 shares of common stock at the current market price of Shs.25 per share. Plan B involves issuance of Shs.5,000,000, 8% bonds at face value. Income before interest and taxes on the new plant will be Shs1.5 million. Income taxes are expected to be 30 %. ABC Corporation has 100,000 shares of common stock outstanding.

i. Calculate the EPS resulting from both plans. (8 marks)

ii. Which plan would you advise on.? (2 marks)

c) Describe the nature of the following liabilities.

i. current portion of long term debt

ii. Contigent liability

iii. warrant expense

iv. unearned revenues

v. Accrued expenses. (10 marks)

QUESTION TWO (20 MARKS)

Gateway Corporation has three classes of shares as follows:

6% Cumulative preferred stock of Shs.10 par issued and paid in form of 200,000 shares ..2,000,000

7% noncumulative preferred stock Shs.25 par issued and paid in form of 80,000 Shares….2000,000

200,000 Shares of common Stock of Shs.10 par……2,000,000

The operations of Gateway Corporation were unprofitable in 2015, 2016 and 2017 and no dividends were declared during those three years. In 2018 however, a large net income was earned and Gateways Directors on Dec 31 2018 that Shs.900,000 should be distributed as dividends.

Required:

a) Compute the dividends to be paid to each Class of shares. (8 marks)

b) Show the Ledger accounts to record the payment of these dividends. (12 marks)

QUESTION THREE (20 MARKS)

The stockholders' equity section of Tinker Corporation as at 31 December 2018 was as follows:

TINKER CORPORATION

STATEMENT OF FINANCIAL POSITION (EXTRACT)

	Shs."000"
Paid –in-Capital	
Preferred Stock, Cumulative, 10,000 shares authorized, 6,000 shares issued and Outstanding	600,000
Common Stock, no par 750,000 authorized, 600,000 shares issued	1,200,000
Total paid-in-Capital	1,800,000
Retained Earnings	1,858,000
Total paid in Capital and Retained Earnings	3,658,000
Less: Treasury Stock (12,000 Shares)	64,000
Total Shareholders Equity	3,594,000

The CEO of the Company does not understand the above Statement clearly.

Required.

Review the stockholders' equity section and as the Chief Accountant, answer the following questions from your CEO.

a) How many shares of Common Stock are Outstanding? (2 marks)

b) Assuming there is a Stated Value, what is the stated value of common Stock? (4 marks)

c) What is the Par Value of Preferred stock (2 marks)

d) If the annual dividend on preferred stock is Shs. 30,000,000, what the dividend rate on preferred stock? (4 marks)

e) If dividends of Shs. 60,000,000 were in arrears on preferred stock, what would be the balance in the retained Earnings? (2 marks)

QUESTION FOUR (20 MARKS)

a) Liverpool Corporation which manufactures appliances for other Companies made sales of shs.200,000,000 subject to product Warranties. In the past years between 4% and 6% of products proved defective and Liverpool management estimated that 5% of the products it will sell this year will require repair or replacement during the one year warranty period. The defective Merchandise totaled to Shs.8,000,000 half of which was repaired and half was replaced.

Required

i. Calculate the estimated warranty expense for the period. (2 marks)

ii. Show Journal Entries to record the estimated Warranty Expense. (6 marks)

iii. Show the Ledger accounts to record the repaired and replaced Merchandise. (8 marks)

b) Briefly explain the nature of Contingent Liability. (4 marks)

QUESTION FIVE (20 MARKS)

Pima company limited provided the following balances on 31st December 2018

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Sh10, 80,000 ordinary shares		800,000
12% preference shares		600,000
8% debentures		400,000
Sales and purchases	300,000	1050,000
Debtors and creditors	227,000	56,000
Provision for doubtful debts		5,000
Returns	50,000	20,000
Insurance	40,000	
Salaries	120,000	
Building (cost 1400,000)	1320,000	
Plant and machinery (cost 350,000)	280,000	
Motor vehicle (cost 250,000)	150,000	
Directors fee	23,000	
Commission	80,000	19, 000
Bad debts	15,000	
Bank	280,000	
Goodwill	450,000	
Discount	38,000	
Profit and loss		500,000
Stock 1.1.2018	50,000	
Vehicle expenses	30,000	
	3450,000	**3450,000**

Additional information

1. Shs. 2,000 of debtors were declared bad and written off; the provision is to be adjusted to 2.5% of the remaining debtors
2. Unpaid insurance is shs. 2,000; prepaid salaries were shs. 20,000
3. Auditors fees sh 12 000
4. Accrued directors fee is sh 2000
5. National social security funds sh 8 000 is included in the salaries figure.
6. Corporation tax rate is at 30%
7. The directors have recommended
   - A transfer of shs. 2,000 to general reserves
   - Payment preference dividends
   - To pay shs. 0.20 per ordinary share

Required

a) Income statement for the year ended 31.12.2018 (12 marks)

b) Statement of financial position as at a 31.12.2018 (8 marks)