MACHAKOS UNIVERSITY

University Examinations for 2019/2020 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING BANKING AND FINANCE

SECOND………. SEMESTER EXAMINATION FOR

BACHELOR OF ECONOMICS AND FINANCE

BACHELOR OF EDUCATION (ARTS)

BACHELOR OF COMMERCE

BAC 201: ACCOUNTING FOR LIABILITIES & EQUITIES

DATE: **TIME:**

INSTRUCTIONS:

i) Answer question one and any other two questions.
ii) Marks allocated for each question are shown at the end of the question.
iii) Show your working where necessary.

QUESTION ONE COMPULSORY (30 MARKS)

a) A lessor leases out an asset on terms which constitute a finance lease. The primary period is five (5) years commencing 1 July 2021 and the rental payable is Sh. 3,000,000 per annum (in arrears). The cash price of the asset in question as at 1 July 2021 can be assumed to be Sh. 11,372,000 and the economic life of the asset is 5 years. The rate of interest implicit in the lease is 10%.

Required:

i) Present Value (PV) of minimum lease payment (3 marks)
ii) Journal entry in the books of the lessee on 1 July, 2020. (2 marks)
iii) Depreciation charge per annum (2 marks)

NOTE: Discount factors to be rounded to four (4) decimal places.

b) Tsuma lost his inventory in a fire on 27 March, 2019. The last time stock taking had been done was on 31 March, 2018, the last balance sheet date, when the inventory was valued at cost at Sh. 39,000,000. Purchases from then until 27 March, 2019 amounted to Sh. 163,400,000 and sales in that period were Sh. 197,000,000. All sales were made at a uniform gross profit margin of 20%.

Required: Prepare a trading account for the year ending 31 March 2019 (10 marks)

c) Explain FIVE (5) differences between liabilities and equities. (10 marks)

d) Highlight THREE factors which give rise to deferred tax (3 marks)

QUESTION TWO (20 MARKS)

The following are summaries of the cash book and bank accounts of J Duncan who does not keep his books using the double entry system.

Bank summary	**sh. 000**	**sh. 000**
Balance on 1 January 2020		16,000
Receipts	32,000	
Accounts receivable	8,200	60,200
Cash banked		76,200
Payments		
Trade accounts payable	37,200	
Rent	2,800	
Machinery	15,000	
Wages	12,200	
Insurance	2,900	
Accounts receivable (dishonored cheque)	500	
Loan interest	600	**71,000**
Balance on 31 December 2020		5,200

Cash summary	**shs**	**shs**
Balance on 1 January 2020		600
Receipts		
Cash sales	28,000	
Accounts receivable	800	28,800
		29,400
Payments		
Drawings	19,000	
Repairs	600	
Electricity	1,500	
Cash banked	8,200	29,300
Balance on 31 December 2020		100

The following referred to 2020	**shs**
Bad debts written off	800
Discounts received	700
Goods withdrawn by J Duncan	600
Credit note issued	2,400

The following information is available	1st Jan 2020	31st Dec 2020
	Shs	Shs
Inventory	8,200	6,400
Machinery	25,200	31,800
Rent prepaid	400	
Rent owing		500
Account receivable	12,600	10,000
Account payable	4.800	5,000
Loan from bank at 8%	10,000	10,000
Loan interest owing		200

You are required to:

(a) Calculate the value of J Duncan's capital on 1 January 20020 (10 marks)

(b) Prepare the income statement for the year ending 31 December, 2020. (10 marks)

QUESTION THREE (20 MARKS)

Assume that a company purchased a fixed asset in 1st January 2018 at a cost of Sh. 24,000,000. The residual value of the asset is assumed to be Nil, and it is to be depreciated on a straight line basis over 4 years. The company claims 100% capital allowance in the first year and the corporation tax rate for each of the four years is assumed to be 35%. Profit after charging depreciation is Sh. 120,000,000 in each of the four years. No capital expenditure takes place in 20119, 2020 and 2021.

Required

a) Compute deferred tax for year 2018. (5 marks)
b) Analyze timing differences. (5 marks)
c) Calculate profit after tax for each of the years. (5 marks)
d) Journal entries to record the income tax expense and related deferred tax liability for tax years 2018 and 2019. (5 marks)

QUESTION FOUR (20 MARKS)

Giving reasons, classify the following as either liability or equity

a) Company B issues ordinary shares. Shareholders are entitled to a pro rata share of any dividends or other distributions of the entity. Dividends are discretionary. (3 marks)

b) The facts are the same as in (a)above, except that, because of legal requirements in its jurisdiction, Company B is required to pay an annual dividend of at least 10% of the par value of its issued shares. (3 marks)

c) The facts are the same as in (a) above. However, in this case, on company B's jurisdiction, tax is not payable on distributed profit under sh. 2,000,000. A 50% tax rate applies to all undistributed profits and to any distributed profits in excess of sh. 2,000,000. Consequently, company B always plans to make dividend payment of at least 2,000,000 in the light of the significant tax benefit. (3 marks)

d) The facts are the same as in (a). However, in this case, company B must redeem the shares at par in the event of an initial public offering (IPO). Company B has discretion on whether or not to initiate an IPO. (3 marks)

e) Company B has 1,000,000 preference shares on issue, which are all held by institutional investors. The preference shares must be redeemed for cash on the earlier of five years from the issue date of the shares or the date upon which SME A initiates an IPO. SME A has discretion on whether or not to initiate an IPO. (3 marks)

f) There are some financial instruments that meet the definition of a liability but are classified as equity because they represent the residual interest in the asset an entity. Comment. (5 marks)

QUESTION FIVE (20 MARKS)

a) Boresha bank agreed to lend Kikwetu company sh. 250,000 on 1 January 2020. Kikwetu company signed a sh. 250,000, 5% six months note payable. Assume Kikwetu Company closes its books of account on 31 March.

Required:

i) Partial Income Statement as at 31 March 2020 (2 marks)
ii) Balance Sheet extract as at 31 March 2020 (3 marks)

b) Ziki Limited sold bonds with a par value of sh. 500,000 and a four year life on 1 January 2021. The coupon rate was 15% while the market rate at the date of issue was 12%.

i) Determine the market value of the bond on the date of issue. (3 marks)
ii) Show the journal entry necessary to record the issue. (2 marks)

c) Define the following terms and explain their accounting treatment.

Notes payable (2 marks)

Gain contingency (2 marks)

Retained earnings (2 marks)

Debentures (2 marks)

Dividends declared (2 marks)