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**GARISSA UNIVERSITY**

**UNIVERSITY EXAMINATION 2020/2021 ACADEMIC YEAR TWO**

**SECOND SEMESTER EXAMINATION**

**SCHOOL OF BUSINESS AND ECONOMICS**

**FOR THE DEGREE OF BACHELOR OF BUSINESS MANAGEMENT**

**COURSE CODE: BBM 229**

**COURSE TITLE: FINANCIAL ACCOUNTING 2**

**EXAMINATION DURATION: 2 HOURS**

**DATE: 20/08/2021 TIME: 3.00-5.00 PM**

**INSTRUCTION TO CANDIDATES**

* **The examination has FIVE (5) questions**
* **Question ONE (1) is COMPULSORY**
* **Choose any other TWO (2) questions from the remaining FOUR (4) questions**
* **Use sketch diagrams to illustrate your answer whenever necessary**
* **Do not carry mobile phones or any other written materials in examination room**
* **Do not write on this paper**

**This paper consists of EIGHT (8) printed pages *please turn over***

**QUESTION ONE (COMPULSORY)**

1. In the context of autonomous branches, describe the accounting treatment in the books of the head office of the following items.
2. Goods Sent to the Branch. (2 Marks)
3. Branch expenses paid by the Head office. (2 Marks)
4. Head office Debtors Paying Cash to the Branch. (2 Marks)
5. In accordance with international accounting standards (IAS) 8. Accounting policies, Change in accounting estimates and Errors, Explain the circumstances in which an entity is permitted to change it is accounting policies. (4 Marks)
6. Briefly explain the Rule in Garner vs Murray (4 Marks)

AB and C have been in partnership sharing profit and losses in the ratio of 2:2:1 respectively. Their financial year ends in 30 September. A decided to quit the partnership with effect from 10 may 2018. The remaining two partners, B and C, decided to dissolve the partnership from that date. The terms of dissolution were that the assets were to be realized; outstanding debts paid and remainder to be shared by the partners. A was to be paid in an equitable manner, distribution of cash being made as soon as possible.

The following is the statement of financial position of the partnership as at 10 may 2018.

|  |  |  |
| --- | --- | --- |
| **Assets:** | Sh. 000 | Sh. 000 |
| Non-current assets |  |  |
| Land and building |  | 182,000 |
| Plant and machinery |  | 73,600 |
| Fixture and fittings |  | 20,800 |
| Motor vehicle |  | 7,200 |
| Intangible assets (Goodwill) |  | 89,200 |
|  |  | **372,800** |
| **Current Assets** |  |  |
| Inventory | 68,000 |  |
| Trade receivables | 62,000 |  |
| Bank balance | 9,200 |  |
| Cash balance | 3,200 | **142,400** |
|  |  | **515,200** |
| Capital and Liabilities |  |  |
| Capital Accounts |  |  |
| A |  | 100,000 |
| B |  | 64,000 |
| C |  | 40,000 |
|  |  | **204,000** |
| Current Account | 32,000 |  |
| A | 22,000 | **54,000** |
| B |  | **258,000** |
| C |  |  |
|  |  |  |
| **Long term Liability** |  |  |
| Bank Loan |  | 160,000 |
|  |  |  |
| **Current Liability** |  |  |
| Trade payables | 33,200 |  |
| Bank Overdraft | 64,000 | 97,200 |
|  |  | **515,200** |
|  |  |  |

**Additional information:**

1. The partnership had an insurance policy which entitled the firm to sh. 40,000,000 immediately a partner left.
2. Dissolution expenses amounted to sh. 1,800.000 and were paid on august 2018.
3. As soon as sufficient money was available, all the outstanding payables were paid after the discount received which amounted to sh. 1,000,000.
4. Assets were sold and the monies received on piecemeal basis as follows.

|  |  |  |
| --- | --- | --- |
| Date: | Particulars | Amount sh. 000 |
| 30 may 2018 | Insurance policy | 40,000 |
|  | Insurance benefit received (interest) | 16,000 |
|  | Land and building | 180,000 |
| 25 June 2018 | Plant and machinery | 41,200 |
|  | Trade receivables | 26,000 |
| 20 July 2018 | Motor vehicle | 6,400 |
|  | Fixture and fittings | 8,800 |
| 15 August 2018 | Plant and machinery | 32,400 |
|  | Fixture and fittings | 8,000 |
| 20 September 2018 | Inventory | 68,000 |
|  | Trade receivables | 40,000 |
|  |  |  |

Required:

1. Statement showing how the proceeds of the dissolution will be shared between the partners. (8 Marks)
2. Realization account. (4 Marks)
3. Partners’ capital accounts (4 Marks)

**QUESTION TWO**

1. Briefly explain the five main components of a set of published financial statements. (5 Marks)
2. Michael and Stella were in partnership sharing profits and losses equally until 30 April 2011 when they decided to convert the partnership into a limited company, Michelle Ltd. The company was registered immediately.

The following trial balance was extracted on 30 April 2012; one year after the conversion:

|  |  |  |
| --- | --- | --- |
|  | **Sh. ‘000’** | **Sh. ‘000’** |
| Capital accounts: Michael  Stella  Drawings to 30 April 2011: Michael  Stella  Current accounts: Michael  Stella  Net profit to 30 April 2011  Revenue  Production costs  Distribution costs  Administrative expenses  Inventory as at 30 April 2011  Interest paid on loan stock  Income tax  Dividends paid  Property, plant and equipment  Accumulated depreciation as at 30 April 2011  Suspense account  Trade receivables  Cash and cash equivalents  Trade payables  Provisions (legal claim)  Loan stock  Lease rentals  Deferred tax | 14,000  6,000  225,000  21,000  78,000  54,600  9,000  6,000  171,000  148,000  40,370  24,000  \_\_\_\_\_  796,970 | 80,000  60,000  8,000  2,000  20,000  390,000  600  46,770  3,600  36,000  12,000  120,000  18,000  796,970 |

**Additional information:**

1. No entries were made to record the conversion of the partnership into a limited company. The assets were taken over by the company on 1 May 2011 at their book values except for land which was revalued to Sh.40 million. The company issued to the partners’ 16 million ordinary shares of Sh.10 each in settlement of their outstanding capital account balances.
2. A legal claim of Sh.30 million was lodged against the company during the year by a customer. The directors estimate that there was a 40% possibility of the claim being successful and had made a provision of Sh. 12 million which was included in administrative expenses.
3. Property, plant and equipment as at 30 April 2012 comprised:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Land**  **Sh. ‘000’** | **Building**  **Sh. ‘000’** | **Plant, equipment and furniture**  **Shs ‘000’** |
| Cost  Accumulated depreciation  Useful life (years) | 36,000  -  - | 54,000  13,500  50 | 81,000  33,270  4 |

1. Depreciation is to be provided on a straight-line basis and apportioned as follows:

80% to cost of sales

10% to distribution costs

10% to administrative expenses

Full year's depreciation is provided in the year of purchase and none in the year of disposal.

1. Closing inventory as at 30 April 2012 was valued at Sh.66 million.
2. The income tax amount of Sh.600, 000 included in the trial balance was the estimated tax as at 30 April 2011. Current year's tax is estimated at Sh.4.5 million. In addition, a deferred tax liability of Sh. 18 million was provided for as at 1 May 2011. As at 30 April 2012, net taxable temporary differences were Sh.84 million. The tax rate is 30%.
3. On 1 May 2011, the company leased some machines that are used in the production process. The lease was for five years. The rental payments were Sh. 12 million payable semi-annually in arrears. The fair value of the machines was Sh.93 million. Depreciation is to be charged on a straight-line basis and allocated to cost of sales. The interest rate implicit in the lease is 5% per half year.
4. The suspense account represents sales proceeds from plant and equipment which cost Sh. 18 million and was disposed of during the year. The accumulated depreciation of the plant and equipment as at 30 April

2011 was Sh. 13.5 million. Any gain or loss on disposal is to be adjusted in the depreciation expense account.

**Required:**

1. Statement of comprehensive income for the year ended 30 April 2012. (8 Marks)
2. Statement of financial position as at 30 April 2012. (7 Marks)

**QUESTION THREE**

The trial balance was extracted from the books of Ngombe Ltd. as at 31 October 2020.

|  |  |  |
| --- | --- | --- |
|  | **Sh. “000”** | **Sh. “000”** |
| Land and buildings at a cost | 810,00 | - |
| Plant a cost | 468,000 | - |
| Purchases | 234,000 | - |
| Distribution expenses | 30,000 | - |
| Administration expenses | 16,500 | - |
| Loan interest piad | 6,000 | - |
| Leased plant rental | 66,000 | - |
| Inventories(1 November 2011) | 113,400 | - |
| Accounts receivable | 159,600 | - |
| Investments ( Long term) | 270,000 | - |
| Revenue | - | 835,200 |
| Ordinary shares( sh.each) | - | 450,000 |
| Income from investment | - | 13,500 |
| Retained earnings | - | 358,000 |
| 8% debentures | - | 150,000 |
| Accumulated depreciation :  Buildings  Plant | -  - | 180,000  78,000 |
| Dividends paid | 45,000 | - |
| Accounts payable | - | 100,200 |
| Deferred tax | - | 37,200 |
| Bank balance | - | 16,200 |
|  | 2,219,100 | 2,219,100 |

**Additional information:**

1. Inventories were valued at sh. 129.6 millions as at 31 October 2020.
2. The 8% debentures were issued on 1 January 2020 and interest is payable six months in arrears.
3. The income tax for the year ended 31 October 2020 was estimated at sh. 89.7 million. The deferred tax provision as at 31 October 2020 was increased to sh. 42.3 million.
4. The land and Buildings were purchased on 1 November 2004. The cost of Land was sh. 210 million. No land or buildings have been purchased by Ngombe Ltd. since then. However, 1 November 2011, the land and buildings were professionally valued at sh. 240 million and sh. 525 million respectively. The estimated useful life of buildings before revaluation was 50 years. However, the revaluation did not affect the useful life of the buildings.
5. Plant is depreciated at 15% per annum using the reducing balance method. Depreciation expense is to be included under cost of sales in the income statement.
6. On 1 November 2019, Ngombe Ltd. entered into a five year lease agreement for an item of plant. This item had an estimated useful life of five years. The annual rental which was payable in advance with effect from I November 2019 was sh. 66 million. The fair value of the plant is sh. 276 million and the implicit interest rate is 10% per annum.

**Required:**

1. Income statement for the year ended 31 October 2020. (10 Marks)
2. Statement of financial position as at 31 October 2020. (10 Marks)

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**QUESTION FOUR**

1. Financial statements are prepared with underlying basics assumptions. Explain the three fundamental assumptions recognized as underlying the  
   preparation of financial statements. (6 marks)
2. Mr. Mwadafu operates a sole proprietorship dealing in cement. The business has a head office in Mombasa and a branch in Athi River. The branch maintains its own books. As at 31 December 2020, the trial balances of the head office and the branch were as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Shs.** | **Shs.** | **Shs.** | **Shs.** |
| Freehold land and buildings (cost) | 1,400,000 |  |  |  |
| Furniture and equipment (cost) | 312,000 |  | 100,000 |  |
| Debtors | 160,000 |  | 120,000 |  |
| Remittances |  | 1,500,000 | 1,524,000 |  |
| Sales |  | 2,800,000 |  | 1,871,660 |
| Cash at bank | 80,000 |  | 20,000 |  |
| Inventory at cost – 1 January 2020 | 519,000 |  | 270,600 |  |
| Rent and rates | 80,000 |  | 40,000 |  |
| Goods sent/received, at cost |  | 1,200,000 | 1,182,500 |  |
| Purchases | 2,797,980 |  |  |  |
| Wages and salaries | 170,000 |  | 130,000 |  |
| Branch/head office current account | 1,567,560 |  |  | 1,550,060 |
| General expenses | 300,000 |  | 250,000 |  |
| Capital – 1 January 2020 |  | 1,788,740 |  |  |
| Creditors |  | 247,800 |  | 165,380 |
| Bank overdraft |  |  |  | 50,000 |
| Drawings | 150,000 | \_\_\_\_\_\_\_ | \_\_\_\_\_\_\_ | \_\_\_\_\_\_\_ |
|  | 7,536,540 | 7,536,540 | 3,637,100 | 3,637,100 |

**Additional information:**

1. Goods sent to the branch on 24 December 2020 and which had a cost value of Sh.17, 500 were stolen in transit. Although the insurance company has agreed to meet the claim to the extent of 60% of the cost, no entry has been made in the books.

2. Inventories at cost on 31 December 2020 were: Head office – Sh.473, 700; Branch – Sh.126, 450.

3. Depreciation on furniture and equipment is to be provided at the rate of 10% per annum on cost.

4. A commission of 10% is payable to staff both at the head office and branch. The commission is based on net profits before charging these commissions.

**Required:**

1. Head office and Branch profit and loss accounts for the year ended 31 December 2020.

(5 Marks)

1. Branch current account and head office current account reconciling the balances as at 31 December 2020. (5 Marks)
2. Combined balance sheet as at 31 December 2020. (4 Marks)

**QUESTION FIVE**

1. The Companies Act allows a company, if authorized by its articles of association, to issue preferences shares which can be redeemed by the company according to the terms of the issue. Highlight the legal restrictions which apply to such redemption of preferences shares. (4 Marks)
2. Maridadi company ltd, sells high resolution television sets on both cash basis and hire purchase terms each television costs sh. 16,000 and is sold at sh20, 000 on cash basis. If a television set is sold on hire purchase terms a deposit of sh5, 000 is paid followed by ten installments of sh2, 000 each.

The company recognizes gross profit on television sets sold on hire purchase terms based on cash collected in the period and excludes television sets n hire-purchase terms from its closing stock

The company has a policy of valuing television sets repossessed from hire-purchase customers who have defaulted on payment at 60% of the unpaid installments. Repossessed television sets are sold on cash basis at the same gross profit rate television sets sold on cash basis

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Provided below is the trial balance of the company as at 31` March 2020  **Maridadi Company Ltd**  **Trial balance as at 31 March 2020** | | | | | | | | |
|  | | | **Sh’000’** | | | **Sh ‘000’** | | | |
| Fixed Assets(Costs)  Hire- Purchase Debtors  Operating Expenses  Provision For Unrealized Gross Profit As At 1 April 2019  Sales  Trade Creditors  Hire-Purchases Debts(Defaulted)  Share Capital  Share Premium  Bank And Cash Balances  Purchase  Retained Profit (1 April 2019)  Stock (1 April 2019) | 3,000  900  574  36  210  3,424  480 | | 270  4,852  520  2,000  500  482 | | |
|  | | | 8,624 | | 8,624 | | |

**Additional Information**

* 1. Cash sales of new television sets in the year ended 31 March 2020 amounted to sh. 1,200,000
  2. Following default on payments by hire-purchase customers, four television sets were repossessed and re-sold on cash basis in the year ended 31 March 2020. The total amount defaulted on was sh. 36,000 which appears in the hire purchase debts (defaulted) account
  3. Both opening and closing stock comprised only new television sets
  4. During the year ended 31 March 2020, the company collected sh. 2714,000 from hire purchase installments excluding deposits
  5. Depreciation is to be provided on the fixed assets at the rate of 10% per annum on cost
  6. The directors have recommended a first and final dividend of 10 %

**Required**

1. The value of closing stock as at 31st March 2020. (3 Marks)
2. Hire purchase debtors account as at 31 March 2020. (4 Marks)
3. Income Statement for the year ended 31 March 2020. (5 Marks)
4. Statement of Financial Position as at 31 March 2007. (4 Marks)