UNIVERSITY OF NAIROBI

MODULE II DEGREE PROGRAMME 2011/2012 (NAIROBI DAY)

SECOND YEAR EXAMINATIONS FOR THE DEGREE OF BACHELOR OF COMMERCE

DAC 202 : ACCOUNTING FOR EQUITIES

DATE: DECEMBER 17, 2012 **TIME: 2.00 P.M. – 4.00 P.M.**

INSTRUCTIONS

1. **Attempt all the questions.**
2. **Marks allocated are shown at the end of each question.**

Question One

The following balances were extracted from the books of Simolatewa Ltd on December 31, 2011.

Interest revenue	120,400
Cash	71,400
Sales	1,932,000
Accounts Receivable	210,000
Sales returns and allowances	210,000
Prepaid insurance	28,000
Allowance for doubtful accounts	9,800
Sales discount	63,000
Land	140,000
Equipment	280,000
Building	196,000
Cost of goods sold	896,400
Accumulated depreciation – Equipment	56,000
Accumulated depreciation – Building	39,200
Notes receivable	217,000
Selling expenses	271,600
Accounts payable	238,000
Bonds payable	140,000
Administrative and general expenses	135,800
Accrued liabilities	44,800
Interest expense	84,000
Notes payable	140,000
Loss from earthquake damage (exceptional item)	210,000
Common Stock (par Sh. 7)	700,000
Retained Earnings	29,400

Required:

Prepare a multiple step statement of income for the year ended 31 December 2011. Include EPS information given that 100,000 shares of common stock were outstanding throughout the year. (Corporate tax rate on all items is 30%). (Total 25 marks)

Question Two

On January 1, 2012 Yolanda Ltd signed a six year non concancelable lease agreement to lease an industrial machine. The following information pertains to the lease agreement.

1. The lease requires equal rental payments of Sh. 81,680 beginning Jan. 2012.
2. The fair value of the machine on Jan. 2012 was Sh. 400,000.
3. The machine has an estimated economic life of 10 years with unguaranteed salvage value of Sh. 35,000 Yolanda depreciates similar machines using the straight line method.
4. The lease is non renewable at the termination of the lease, the machine reverts to the lessor.
5. Yolandas incremental borrowing rate is 8 percent per annum. The lessors implicit rate in the lease is unknown to the lessee.
6. The yearly rental payments includes Sh. 1,563.19 of executory costs related to insurance on the machine.

Required:

(a) Compute the present value of minimum rental payments. (5 marks)

(b) Prepare a lease amortization schedule for the period January 1 2012 to January 1, 2014. (9 marks)

(c) Prepare journal entries on the books of the lessee to reflect the signing of the lease and to record the payments and expenses related to these lease for the years 2012 and 2013. Yolanda's year ends on December 31. (11 marks)

(Total 25 marks)

Question Three

Kenya oil exploration company purchases an oil tanker depot on January 1, 2012 at a cost of sh. 2,400,000. The company expects to operate the depot for 10 years at which time it is legally required to dismantle the depot and remove the underground storage tanks. It is estimated that it will cost Sh. 300,000 to dismantle the depot and remove tanks at the end of the depot's useful life. (The effective interest rate is 6%).

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Required:

(a) Prepare the journal entries to record the depot and asset retirement obligation (ARO) for the depot on January 1. 2012. (8 marks)

(b) Prepare any journal entries required to record for the depot and asset retirement obligation on December 31, 2012. The company uses the straight line method of depreciation and estimates the residual value of the depot to be zero. (12 marks)

(c) On December 31 2021; the company pays Sh. 320,000 to a demolition firm to dismantle and remove the tanks. Prepare journal entry for the settlement of asset retirement obligation. (5 marks)

(Total 25 marks)

Question Four

Presented below is information relating to lakeside company Ltd.

Statement of financial position
As at 31 December 2011

Cash		8,000
Accounts receivable	175,000	
Less allowance		
Doubtful accounts	(20,000)	155,000
Inventories		271,000
Prepaid expenses		6,000
Land		50,000
Equipment (net)		153,000
Total Assets		Sh. 643,000
Liabilities and shareholders equity		
Notes payable (short term)		92,000
Accounts payable		163,000
Accrued liabilities		18,000
Common stock (Sh 1 par)		72,000
Retained earnings		298,000
Total liabilities and Shareholders equity		Sh. 643,000

Statement of income for the year ended 31 Dec 2011

Sales		2,800,000
Cost of goods sold		
Inventory Jan 1, 2011	200,000	
Purchases	2,031,000	

Available for sale	2,231,000	
Inventory Dec 31, 2011	271,000	(1,960,000)
Gross profit		840,000
Operating expenses		506,000
Net income		334,000

Required

(a) Compute the following ratios or relationships for lakeside company. Assume the ending account balances are representative unless the information provided indicates differently:

(i) Current ratio
(ii) Inventory turnover
(iii) Receivables turn over
(iv) Earnings per share
(v) Net profit margin
(vi) Rate of return on assets

(18 marks)

(b) Indicate for each of the following transactions whether the transaction would improve (I), weaken (w) or have no effect (NE) on the current ratio. Briefly explain.

(i) Write off of uncollectible receivables Sh 6,800.
(ii) Repurchase of capital stock for cash.
(iii) Pay Sh. 46,000 on notes payable (short term).
(iv) Collect Sh. 70,000 on accounts receivable.
(v) Buy equipment on account.
(vi) Give an existing customer a short term note in settlement of account

(7 marks)
(Total 25 marks)
