TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C3: ACCOUNTANCY FOR TAX PRACTITIONERS

MONDAY 14 DECEMBER 2015

TOTAL MARKS – 100; TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question. You will be told when to start writing.

2. This question paper consists of FIVE (5) questions of twenty (20) marks each. You MUST attempt all the FIVE (5) questions.

3. Enter your Student number and your National Registration Card number on the front of the answer booklet. Your name must **NOT** appear anywhere on your answer booklet.

4. Do **NOT** write in pencil (except for graphs and diagrams).

5. **Cell Phones** are **NOT** allowed in the Examination Room.

6. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.

7. All workings must be done in the answer booklet.

8. Present legible and tidy work.

9. Graph paper (if required) is provided at the end of the answer booklet.

Answer all FIVE (5) Questions

QUESTION ONE

Mamala Enterprises deals in various electrical appliances. It was formed 10 years' ago. Its accountant resigned on 1st January 2014. The bookkeeper was consequently left in charge of the accounts department.

The bookkeeper has provided you with the following information to help him prepare the financial statements for the year to 31st May 2015.

	31st May 2014	31st May 2015
	K	K
Inventory	20,000	28,000
Trade receivables	48,000	39,000
Trade payables	55,000	67,000
Cash at bank	18,000	22,000
15% loan (note 1)	100,000	80,000
Property, plant and equipment (note 2):		
Cost	200,000	200,000
Accumulated depreciation	97,600	?
Water and electricity accrued	1,400	2,400
Insurance prepaid	1,500	1,900
profit or loss balance (credit)	200,000	?

The following information is relevant:

1) The loan was acquired on 30th May 2014. It is a five year loan. The business is required to pay back the loan in five equal instalments over five years on 31st May of each year. Interest is charged on the opening loan balance. Interest for the year to 31st May 2015 has neither been paid nor accrued for.

2) Property, plant and equipment are depreciated at an annual rate of 20% using reducing balance method.

3) During the year to 31st May 2015, following payments were made:

	K
Salaries and wages	140,000
Water and electricity	24,000
Insurance	19,000
Other expenses	37,000
Trade payables	190,000

4) Mamala Enterprises received K330,000 from its credit customers during the year to 31st May 2015.

5) Cash drawings for the year to 31st May 2015 amounted to K8,000 per month.

6) All sales and purchases were on credit.

Required:

(a) Prepare the statement of profit or loss for Mamala Enterprises for the year ended 31st May 2015. (10 marks)

(b) Prepare the statement of financial position for Mamala Enterprises as at 31st May 2015. (10 marks)

[Total: 20 Marks]

QUESTION TWO

The following is a summary of the receipts and payments of the Lusaka Games Club, a centre for various competitions in Computer Games.

Lusaka Games Club

Receipts and payments account for the year ended 30 September 2014

	'K'		'K'
Balance b/f	2,520	Administrative expenses	1,956
Proceeds from sale of		Rent	16,824
Competition tickets	5,244	Donations to local orphanage	420
Members' subscription:		Prizes for competitions	3,240
Annual	17,883	Printing and stationery	2,148
Life	5,961	Supporting staff costs	15,300
Donations	2,124		
Fees received from visitor			
Game players	6,000		
Balance c/d	156		-
	39,888		39,888
		Balance b/d	156

Additional notes:

(i) Inventory of competition prizes was valued at K456 on 1 October 2013 and at K552 on 30 September 2014. Additionally, K696 was owing to suppliers of competition prizes on 1 October 2013 whereas K816 was owing on 30 September 2014.

(ii) Annual subscription in arrears was K780 on 1 October 2013 and K1,020 on 30 September 2014 whereas subscription in advance was K120 and K444 on 1 October 2013 and 30 September 2014 respectively.

(iii) On 1 October 2013, the club's equipment had a net book value (NBV) of K11,700 and a cost of K17,040. Depreciation to be charged for this year is K2,340.

(iv) It is the club's policy to recognize life subscription over a period of three years. The life subscription was received on 1 October 2013.

Required:

(a) Calculate the value of accumulated fund of the Lusaka Games Club as at 1 October 2013. (3 marks)

(b) Prepare an income and expenditure account for the Lusaka Games Club for the year ended 30 September 2014. (11 marks)

(c) Prepare the statement of financial position for the club as at 30 September 2014. (6 marks)

[Total : 20 Marks]

QUESTION THREE

(a) Explain the following errors and give an example for each error.

(i) Error of principle (2 marks)

(ii) Error of complete omission (2 marks)

(b) Distinguish between non-current and current liabilities. (2 marks)

(c) Explain the following qualitative characteristics of financial information.

(i) Relevance (2 marks)

(ii) Faithful presentation (2 marks)

(iii) Comparability (2 marks)

(d) Explain two (2) disadvantages of statement of cash flow. (4 marks)

(e) State any four (4) reasons why customers may return goods to their suppliers. (4 marks)

[Total: 20 Marks]

QUESTION FOUR

The following figures have been extracted from the books of Mungazi Engineering supplies Ltd at 31 December 2013:

	K'000	K'000
Revenue		8,000
Gross profit		2,000
Average inventory at cost		500
Operating expenses		400
Non current assets		5,400
Current assets:		
Inventory	500	
Trade receivables	400	
Bank	100	
		1,000
Current liabilities		500
Capital		5,900

Required:

(a) Calculate the following for Mungazi Engineering Supplies:

(i) Gross profit margin
(ii) Operating profit margin
(iii) Rate of inventory turnover (use average inventory)
(iv) Return on capital employed (use total assets – current liabilities)
(v) Current ratio
(vi) Quick ratio (12 marks)

(b) Another firm in the same line of business as Mungazi Engineering Supplies, that is Dube Engineering services, has provided you with ratios calculated based on the most recent financial statements for the year ended 31 December 2013.

Dube Engineering services Ltd

Gross profit margin	25%
Rate of inventory turnover	9 times
Operating profit	10%
Return on capital employed	12½%
Current ratio	1:1
Quick ratio	0.5:1

Required:

Comment on the performance of Mungazi Engineering and Dube Engineering services Ltd, using ratios you have calculated in (a) above and those provided for by a peer company, clearly indicating which of the two companies was the most successful for the year ended 31 December 2013. (8 marks)

[Total: 20 Marks]

QUESTION FIVE

(a) The following information relates to Rata Ltd for the year to 31st May 2015.

	K
Depreciation charge for the year	26,000
Decrease in trade receivables	4,000
Increase in trade payables	6,000
Increase in inventory	3,000
Interest expense	1,200
Interest paid	900
Income tax expense	1,900
Income tax paid	2,100
Profit for the year after interest and tax	15,000
Cash paid to acquire property, plant and equipment	22,000

Required:

Calculate the net cash inflow or outflow from operating activities. (8 marks)

(b) The Accounts Assistant of Manana Enterprises carried out reconciliation of trade payables ledger control account balance in the general ledger with balance as per list of trade payables in payables ledger. The balance as per trade payables ledger

control account was K18,000 while list of trade payables balances was equal to K23,000.

Upon investigations, the Accounts Assistant discovered the following errors.

1. Credit purchases amounting to K3,000 were omitted from Manana Enterprises records.
2. Goods returned to credit suppliers of K2,000 were not recorded in the control account.
3. Cash paid to Bababa Ltd, a credit supplier, of K42,000, was recorded in Bababa Ltd account as K38,000. The payment was correctly recorded in the control account.
4. Discount received from Mabana, a credit supplier, of K1,500, was recorded in Mabana's account as though it were a credit purchase.

Required:

(i) Recalculate trade payables ledger control account balance, taking into account errors (1) to (4) above, were applicable. (2 ½ marks)

(iii) Prepare a statement reconciling balance as per list of trade payables with balance as per trade payables ledger control account calculated in (i) above. (5 ½ marks)

(c) The following information relates to Pala Enterprises for the month of June.

1st June 20 units opening inventory at K10 each

6th June 100 units bought at K12 per unit

10th June 90 units sold at K16 per unit

20th June 10 units bought at K13 per unit

Required

Calculate the value of inventory in Kwacha at 30th June using First in First Out (FIFO) method. (4 marks)

[Total: 20 Marks]

END OF PAPER

C3: ACCOUNTANCY FOR TAX PRACTITIONERS

SUGGESTED SOLUTIONS

DECEMBER 2015 EXAMINATIONS

SOLUTION ONE

a) Mamala Enterprises
Statement of profit or loss for the year ended 31st May 2015

	K	K
Sales **W1**		321,000
Opening inventory	20,000	
Add: Purchases **W2**	202,000	
Less: Closing inventory	(28,000)	
Cost of sales		(194,000)
Gross profit		127,000
Less: Expenses		
Water & electricity 24+2.4 – 1.4	25,000	
Insurance 19 +1.5 – 1.9	18,600	
Salaries & wages	140,000	
Depreciation 20% x (200 – 97.6)	20,480	
Other expenses	37,000	
Accrued interest 15% x 100	15,000	
Total expenses		(256,080)
Net loss		(129,080)

b) Mamala Enterprises
Statement of financial position as at 31st May 2015

Assets	K	K
Property, plant & equipment 200 – (97.6+20.48)		81,920
Current		
Inventory	28,000	
Trade receivables	39,000	
Prepayment – insurance	1,900	
Cash at bank	22,000	
		90,900
Total assets		**172,820**
Capital and liabilities		

Capital		
Capital at 1st June 2014 **W3**	33,500	
Add: Retained profit 200,000 – 129,080	70,920	
Less: Drawings 12 x 8,000	(96,000)	
		8,420
Liabilities		
Non-current		
15% Loan(100,000 – 20,000 – 20,000)		60,000
Current Liabilities		
Trade payables	67,000	
15% Loan repayments	20,000	
Accrued loan interest	15,000	
Accrued water & electricity	2,400	
		104,400
Total capital and liabilities		**172,820**

Workings

W1	**Sales**	K
	Receipts from customers	330,000
	Add: closing trade receivables	39,000
	Less: opening trade receivables	(48,000)
	Total sales for the period	321,000

W2	**Purchases**	K
	Payments to suppliers	190,000
	Add: closing trade payables	67,000
	Less: opening trade payables	(55,000)
	Total purchases for the period	**202,000**

W3	**Capital**	K
	Non-current assets 200 – 97.6	102,400
	Current assets 20+48+18+1.5	87,500
		189,900
	Non-current liabilities	80,000
	Current liabilities 20+1.4+55	76,400
		(156,400)
	Capital at 1st June 2014	**33,500**

SOLUTION TWO

a) Lusaka Games club Accumulated fund at 1 October 2013

ASSETS	'K'	'K'
Cash at bank and in hand	2,520	
Inventory of competition prizes	456	
Subscription in arrears	780	
Equipment at NBV	11,700	
		15,456
LESS LIABILITIES		
Owing to suppliers of competition prizes	696	
Subscription in advance	120	(816)
Accumulated fund		14,640

b) Lusaka Games club income and expenditure account for the year ended 30 September 2014

INCOME	**'K'**	**'K'**
Annual subscription (w3)	17,799	
Life subscription (w4)	1,987	
Donations received	2,124	
Fees from visitor game players	6,000	
Profit on game competition	1,980	
		29,890
EXPENDITURE		
Administrative expenses	1,956	
Rent	16,824	
Donations to orphanage	420	
Printing and stationery	2,148	
Support staff costs	15,300	
Depreciation on equipment	2,340	(38,988)
Deficit		(9,098)

c) Lusaka Games Club

Statement of financial position as at 30 September 2014

Non-current assets	Cost	dep'n	NBV
	'K'	'K'	'K'
Equipment	17,040	7,680	9,360
Current assets			
Inventory		552	
Subscription in arrears		1,020	1,572
Total assets			10,932
Accumulated fund and liabilities			
Accumulated fund			14,640
Less deficit			(9,098)
			5,542
Current liabilities			
Bank overdraft		156	
Subscription in advance		444	
Owing for competition prizes		816	
Deferred life subscription		3,974	5,390
Total accumulated fund and liabilities			10,932

WORKINGS

1. Profit and loss on game competition

	'K'	'K'
Proceeds from ticket sales		5,244
Opening inventory	456	
Purchases	3,360	
Closing inventory	(552)	(3,264)
Profit on game competition		1,980

2. Competition prizes purchases account

	'K'		'K'
Bank	3,240	owing b/f	696
		Purchases (bal)	3,360
Owing c/d	816		
	4,056		4,056

3. Annual subscription account

	'K'		'K'
Arrears b/f	780	prepaid b/f	120
I/E (bal)	17,799	Bank	17,883
Prepaid c/f	444	arrears c/f	1,020
	19,023		19,023

4. Life membership subscription account

	'K'		'K'
I/E (5,961/3)	1,987	bank	5,961
Balance c/d (deferred)	3,974		---
	5,961		5,961
		Balance b/d	5,961

SOLUTION THREE

a) (i) **Error of principle**

This is where a transaction is recorded in the wrong class of account. For example, purchase of a motor vehicle, a non-current asset, being recorded in motor vehicle expense account instead of an asset account.

(ii) **Error of complete omission**

This occurs when a transaction is completely omitted from the books of account. For instance a credit purchase from Bana is neither debited in purchases account nor credited to Bana account.

b) Non-current liabilities are obligations that will be settled or fall due after the next twelve months while current liabilities are obligations that fall due within the next twelve months from the reporting date.

c) (i) **Relevance**

Relevant financial information must possess either predictive or confirmatory value or both. Further, it

- Should be capable of influencing the economic decisions of users
- Should be provided in time to influence those decisions.

(ii) **Faithful presentation**

This demands that information must be complete, neutral i.e. free from bias, and free from error. For information to be complete, all necessary information has to be included in the financial statements.

(iii) **Comparability**

The way financial statements are prepared should make it possible for them to be compared with previous periods and with other companies.

d) Two (2) disadvantages of statement of cash flow

- It is not possible to arrive at actual profit or loss of the company by simply looking at the statement of cash flow as it only shows the cash position.
- The statement of cash flow is of no use to the company if it is used in isolation. It has to be used in conjunction with other statements such as statement of financial position and statement of profit or loss.

e) Four (4) reasons why customers may return goods to their suppliers

- The goods may be faulty or damaged
- The goods be in excess of what was ordered by customers
- The goods may be of a wrong size
- The goods may be of a wrong colour
- They may be of a wrong make

SOLUTION FOUR

All amounts are in 'K' unless otherwise indicated.

a) i) Gross profit margin = gross profit/revenue x 100
= 2,000/8,000 x100
= <u>25%</u>

ii) operating profit = operating profit/revenue x 100
= 2,000 – 400/8,000
= <u>20%</u>

iii) rate of inventory turnover = cost of sales/average inventory
=8,000 – 2000/5,000
=<u>12 times</u>

iv) return on capital employed = operating profit/capital employed x 100
=2,000 – 400/5,400 +1,000 -500
=1,600/5,900 x 100
=<u>27%</u>

v) current ratio = current assets/current liabilities
= 1,000/500
=2:1

vi) quick ratio = current assets – Inventory/current liabilities
=1,000 – 500/500
=1:1

b) Table of summary results for the two companies.

	Mungazi	Dube
Gross profit margin%	25	25
Operating profit margin%	20	10
Rate of inventory turnover	12 times	9 times
ROCE%	27	12 ½
Current ratio	2:1	1:1
Quick ratio	1:1	0.5:1

Comment on performance

Profitability

Gross margins of the two companies are the same. This means neither of them increased their selling prices nor reduced the cost of purchases than the other. They operated with similar cost levels.

Operating profit margin is higher for Mungazi Engineering, at 20% than for Dube at 10%. This could be due to Mungazi's operating expenses being lower than those of Dube, unlike the reason of sales value of their products as gross margins are similar. Additionally, as return on capital employed is higher for Mungazi at 27% compared to 12 ½ for Dube, it also means Mungazi made efficient utilization of its assets to improve performance.

The rate of inventory turnover is higher by 33.33% for Mungazi compared to Dube, that is 12 times compared to 9 times for Dube. This may mean that Mungazi's Engineering products sell faster than those of Dube. It may be issues of differences in quality or environment in which the two operate. Any specific reason has not been highlighted in the scenario. Probably, the marketing team for Mungazi is

efficient and effective in their operations to ensure the company sells its products at fastest rate ever unlike the peer company.

Liquidity

Both the current and quick ratios indicate that Mungazi is in a better position to meet its short term obligations using short term resources. With a current ratio of 2:1, Mungazi can meet its short term obligations twice more than Dube whose current ratio is 1:1. Though the quick ratio of 0.5:1 may still indicate fair position for Dube, Mungazi has exceeded any acceptable benchmark.

Conclusion:

Except for gross margins, Mungazi has outperformed its peer company Dube in all other areas as shown by the ratios calculated above. It appears the best performer in the absence of any other non-financial data.

SOLUTION FIVE

a) Cash flow from operating activities

	K
Profit after interest and tax	15,000
Add: interest expense	1,200
Add: income tax expense	1,900
Add: depreciation charge	26,000
Add: decrease in trade receivables	4,000
Add: increase in trade payables	6,000
Less: increase in inventory	(3,000)
Cash generated from operations	51,100
Less: tax paid	(2,100)
Less: interest paid	(900)
Net cash inflow from operating activities	**48,100**

b) 1. **Trade payables ledger control account**

	K
Balance as per question	18,000
Add: omitted purchases	3,000
Less: returns outwards	(2,000)
Revised balance	19,000

2. **Trade payables reconciliation statement**

	K
Balance as per list of trade payables	23,000
Add: omitted purchases	3,000
Less: payment to Bababa (42,000 – 38,000)	(4,000)
Less: discount received (2 x 1,500)	(3,000)
Balance as per revised control account	19,000

c) Value of inventory at 30th June

Date	**Details**	**units**	**Balance**	
			Units	**Cost (K)/unit**
1st June	Opening bal.	20@K10	20	10
6th June	Purchases	100@K12	20	10
			100	12
10th June	Sales	90	30	12
20th June	Purchases	10@K13	30	12
			10	13

Value

	K
30 units @ K12	360
10 units @ K13	130
	490

END OF SOLUTIONS