

NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLOGY

DEPARTMENT OF ACCOUNTING

FIRST SEMESTER EXAMINATION: DECEMBER 2005

ACCOUNTING IIA CAC 2106

TIME ALLOWED: 3 HOURS

INSTRUCTIONS TO CANDIDATES

- i) Answer any FOUR questions
- ii) Begin the answer of each question on a fresh page.

<u>QUESTION</u>	<u>TOPIC</u>	<u>MARKS</u>
1.	Capital Structure	25
2.	Analysis of Cashflow	25
3.	(i) Social Accounting	13
	(ii) Issue of shares	12
4.	Inflation Accounting	25
5.	Financial Ratio Analysis	25

QUESTION 1 (25 MARKS)

Silo plc has been formed to trade as a food retailer. It is currently considering three possible long-term capital structures. These are as follows:

Option	CAPITAL STRUCTURE		
	1	2	3
	\$m	\$m	\$m
\$1 ordinary shares	4	10	20
10% \$1 preference shares	6	4	-
12% debentures	<u>10</u>	<u>6</u>	<u>-</u>
	<u>20</u>	<u>20</u>	<u>20</u>

Profits (before interest) for the next three years are estimated as follows:-

Year	
1	\$3m
2	\$5m
3	\$1.8m

Taxation is to be ignored

Required

- a) Calculate the gearing ratio for each financing option. (3 marks)
- b) Calculate the earnings per share for each of the three years assuming:
 - i) option 1 (5 marks)
 - ii) option 2 and (5 marks)
 - iii) option 3 is chosen (5 marks)
- c) Which of the three financing options would you choose and why? (7 marks)

QUESTION 2 (25 MARKS)

- a) Illustrate the difference between accounts prepared on the accruals basis and accounts prepared on a cash basis, by means of a set of accounts for two successive years. (8 marks)
- b) What other aspects of accounting might lead to a difference between accounts as they are normally prepared, and the cash position? (4 marks)
- c) What four questions would you want answered when examining a cashflow statement? Indicate how surplus cash/a cash deficit might be dealt with. (7 marks)

- d) Discuss the implications of the following information revealed by a cashflow statement.
Disposal of fixed assets
Purchase of fixed assets
The need to issue new shares. *(6 marks)*

QUESTION 3 (25 MARKS)

- a) i) Describe how an increase in Gross National Product may not have a positive effect on the well-being of the country. *(3 marks)*
- ii) What types of measures could be used to measure social well being? What difficulties would be discovered in trying to use accounting in measuring these? *(2 marks)*
- iii) What aspects of an organisation's activities could be measured in a 'social audit'? *(2 marks)*
- iv) Describe how there could be conflicts between short-term and long-term benefits. *(1 mark)*
- v) Why has the traditional model of income measurement failed to account for the impact of business activities on the environment? *(4 marks)*
- vi) Describe how PPBS may conflict with departmental budgets. *(1 mark)*
- b) A limited company has a nominal capital of \$120 000 000 divided into 120 000 ordinary shares of \$1 000 each. The whole of the capital was issued at par on the following terms:

	Per share
Payable on application	\$125
Payable on allotment	\$250
First call	\$250
Second call	\$375

Applications were received for 160 000 shares and it was decided to allot the shares on the basis of three for every four for which applications had been made. The balance of application monies were applied to the allotment, no cash being refunded. The balance of allotment monies were paid by the members.

The calls were made and paid in full by the members, with the exception of a member who failed to pay the first and second calls on the 800 shares allotted to him. A resolution was passed by the directors to forfeit the shares. The forfeited shares were later issued to D. Regan at \$900 each.

Required:

Show the ledger accounts recording all the above transactions, and the relevant extracts from a balance sheet after all the transactions had been completed.

(12 marks)

QUESTION 4 (25 MARKS)

- a) Inflation Limited's accounts to 31/12/03, prepared on a historic cost basis and on real or actual values are as follows:

	Historic	Actual
	\$	\$
Taxable Income	100 000	100 000
Tax thereon	<u>50 000</u>	<u>50 000</u>
Distributable balance	50 000	50 000
Dividends	<u>25 000</u>	<u>25 000</u>
Retained Income	25 000	25 000

Inflation in the year to 31/12 /2004 is 20%, while the company tax rate is 30% of taxable income. The dividend payout ratio is 50% of after tax profits.

- i) Compute the historic and actual taxable income, tax etc. for the 2004 year. The change between the 2003 and 2004 figures is inflation driven.
(5 marks)
- ii) Comment on the movement of retained income based on the historic and actual figures. Also comment on the ratio of dividends as a percentage of after tax income in real terms.
(3 marks)
- b) The following information relates to Holding Ltd's merchandise over 5 years:
- | Month | 1 | 2 | 3 | 4 | 5 |
|-----------------------|-----|-----|-----|-----|-----|
| | \$ | \$ | \$ | \$ | \$ |
| Cost price (per unit) | 400 | 440 | 480 | 520 | 560 |
| Sale price (Per unit) | 500 | 540 | 580 | 620 | 660 |
- Using the first month's cost per unit, work out the gross margin for each month. Demonstrate the composition of this margin as between the holding gain and profit.
(8 marks)
- c) Enumerate five weaknesses of Historic Cost Accounting in an inflationary environment.
(5 marks)

- d) State three bases for the computation of profit using traditional accounting and inflation-adjusted accounts and illustrate by means of a practical example. (4 marks)

QUESTION 5 (25 MARKS)

Dollar Ltd sells fixtures. Its financial statements over the last three years follow:-

	2002 S'000	2003 S'000	2004 S'000
Balance Sheet			
Cash	30 000	20 000	5 000
Accounts receivable	200 000	260 000	290 000
Inventory	400 000	480 000	600 000
Net fixed assets	<u>800 000</u>	<u>800 000</u>	<u>800 000</u>
	<u>1 430 000</u>	<u>1 560 000</u>	<u>1 695 000</u>
Accounts payable	230 000	300 000	380 000
Accruals	200 000	210 000	225 000
Bank loan	100 000	100 000	140 000
Long term debt	300 000	300 000	300 000
Ordinary shares	100 000	100 000	100 000
Retained Earnings	<u>500 000</u>	<u>550 000</u>	<u>550 000</u>
	<u>1 430 000</u>	<u>1 560 000</u>	<u>1 695 000</u>
INCOME STATEMENT			
Sales	4 000 000	4 300 000	3 800 000
Costs of goods sold	3 200 000	3 600 000	3 300 000
Net profit	300 000	200 000	100 000

Required:

- i) Compute the following ratios:
- Acid test ratio
 - Current ratio
 - Average collection period
 - Inventory turnover
 - Total debt/worth
 - Long term debt/total capitalisation
 - Gross profit margin
 - Net profit margin
 - Asset turnover
 - Return on assets

(10 marks)

- ii) Comment in detail on the performance of the company over the three years. What is the relationship between Return on capital employed and net profit margin? (10 marks)
- iii) Comment on the limitations of accounting ratios. (5 marks)