

UNIVERSITY OF SWAZILAND

DEPARTMENT OF ACCOUNTING

MAIN EXAMINATION QUESTION PAPER, 2005

**DEGREE/DIPLOMA AND
YEAR OF STUDY**

: D.COM 111

TITLE OF PAPER

: FINANCIAL ACCOUNTING II

TIME ALLOWED

: TWO [2] HOURS

INSTRUCTIONS

- 1. TOTAL NUMBER OF QUESTIONS ON THIS PAPER : FOUR [4]**
- 2. ANSWER QUESTION ONE AND ANY OTHER TWO QUESTIONS**
- 3. THE MARKS AWARDED FOR A QUESTION/PART ARE INDICATED AT THE END OF EACH QUESTION/PART OF QUESTION**
- 4. ALL CALCULATIONS ARE TO BE MADE TO THE NEAREST LILANGENI**
- 5. WHERE APPLICABLE SUBMIT ALL WORKINGS AND CALCULATIONS**

NOTE: YOU ARE REMINDED THAT IN ASSESSING YOUR WORK, ACCOUNT WILL BE TAKEN OF ACCURACY OF THE LANGUAGE AND THE GENERAL QUALITY EXPRESSION, TOGETHER WITH THE LAYOUT AND PRESENTATION OF YOUR FINAL ANSWER.

SPECIAL REQUIREMENT: NONE

THIS PAPER IS NOT TO BE OPENED UNTIL PERMISSION HAS BEEN GRANTED BY THE INVIGILATOR.

QUESTION 1

The balance sheet and additional information relating to Nadex Limited are given below. You are required to prepare a cash flow statement for Nadex limited for the year ended 31 December 2004 using the indirect method together with the relevant notes and workings which must be referenced to the cash flow statement.

Nadex Limited

Balance sheet as at 31 December 2004

| | 2004 E000 | 2003 E000 |
|---------------------------|--------------|--------------|
| Non current assets | | |
| Fixed assets | 400 | 325 |
| Investments | - | 25 |
| Intangible assets | 230 | 180 |
| | ----- | ----- |
| | 630 | 530 |
| | ----- | ----- |
| Current assets | | |
| Stocks | 120 | 104 |
| Debtors | 400 | 295 |
| Short-term investments | 50 | - |
| Cash in hand | 10 | 4 |
| | ----- | ----- |
| | 580 | 403 |
| | ----- | ----- |
| Total assets | 1,210 | 933 |
| | ===== | ===== |

Equity and reserves

| | | |
|------------------------------------|-------|-------|
| Share capital (E1 ordinary shares) | 200 | 150 |
| Share premium account | 160 | 150 |
| Revaluation reserve | 100 | 90 |
| Profit and loss account | 140 | 80 |
| | ----- | ----- |
| | 600 | 470 |
| | ----- | ----- |

Long term liabilities

| | | |
|-------------------|------|------|
| Long term loan | 100 | - |
| Deferred taxation | 80 | 60 |
| | ---- | ---- |
| | 180 | 60 |
| | ---- | ---- |

Current liabilities

| | | |
|--------------------|-------|-------|
| Trade creditors | 122 | 108 |
| Bank overdraft | 88 | 105 |
| Taxation | 120 | 110 |
| Dividends proposed | 100 | 80 |
| | ---- | ---- |
| | 430 | 403 |
| | ---- | ---- |
| Total liabilities | 1,210 | 933 |
| | ===== | ===== |

Additional information:

1. During the year interest of E75,000 was paid, and interest of E25,000 was received.

2. The following information relates to tangible fixed assets.

| | 2004 | 2003 |
|--------------------------|------|------|
| At 31 December | E000 | E000 |
| Cost | 740 | 615 |
| Accumulated depreciation | 340 | 290 |
| | ---- | ---- |
| Net book value | 400 | 325 |
| | ---- | ---- |

3. The proceeds of the sale of fixed assets investments were E30,000.
4. Plant, with an original cost of E90,000 and a net book value of E50,000, was sold for E37,000.
5. Tax paid to the Inland revenue during 2004 amounted to E110,000.

Total (40 marks)

QUESTIN 2

On 1 January 2002, Norway bought a machine costing E20,000 on hire purchase. He paid a deposit of E6,000 on 1 January 2002 and He also agreed to pay two annual instalments of E5,828 on 31 December each year, and a final instalment of E5,831 on 31 December 2004. The implied rate of interest in the agreement was 12%. This rate of interest is to be applied to the amount outstanding in the hire purchase loan account as at the beginning of the year.

The machine is to be depreciated on a straight line basis over five years on the assumption that the machine will have no residual value at the end of that time.

Required:

- (a) Write up the following accounts for each of the three years to 31 December 2002, 2003 and 2004 respectively.
- i. Machine account. (2 marks)
 - ii. Accumulated depreciation on machine account (8 marks)
 - iii. Hire purchase loan account (10 marks)
- (b) Show the balance sheet extracts for the year as at 31 December 2002, 2003, and 2004 respectively for the following items:
- i. Machine at cost. (3 marks)
 - ii. Accumulated depreciation on the machine. (3 marks)
 - iii. Long term liabilities: obligations under hire purchase contract; and (2 marks)
 - iv. Current liabilities: obligations under hire purchase contract (2 marks)

Total (30 marks)

QUESTION 3

Snel Stores has its head office and main store in Mbabane, and a branch store in Steki. All goods are purchased by the head office. Goods are invoiced to the branch at cost price plus a profit loading of 20%. The following trial balances have been extracted from the books of account of both the head office and the branch as at 31 December 2004.

| | Head office books | | Branch books | |
|---|-------------------|-------------|--------------|------------|
| | Dr | Cr | Dr | Cr |
| | E000 | E000 | E000 | E000 |
| Administrative expenses | 380 | | 30 | |
| Distribution costs | 157 | | 172 | |
| Capital (at 1 January 2004) | | 550 | | |
| Cash at bank | 25 | | 2 | |
| Creditors and accruals | | 176 | | 20 |
| Current accounts | 255 | | | 180 |
| Debtors and prepayments | 130 | | 76 | |
| Motor vehicles at cost | 470 | | 230 | |
| Acc.depreciation at 31 Dec. 2004 | | 280 | | 120 |
| Plant and equipment at cost | 250 | | 80 | |
| Acc.depreciation at 31 Dec. 2004 | | 120 | | 30 |
| Proprietor's drawings during the year | 64 | | | |
| Provision for unrealised on branch stocks at 1 January 2004 | | 5 | | |
| Purchases | 880 | | | |
| Sales | | 1200 | | 570 |
| Stocks at cost/ invoiced amount at 1 January 2004 | 80 | | 30 | |
| Transfer of goods to the branch/ from the head office | | 360 | 300 | |
| | 2691 | 2691 | 920 | 920 |

Additional information:

- The stocks in hand at 31 December 2004 were estimated to be as follows:

| | |
|--------------------------|------|
| | E000 |
| At head office (at cost) | 100 |

At the branch (at invoiced price)

48

In addition, E60,000 of stocks at invoiced price had been despatched to the branch on 28 December 2004. These goods had not been received by the branch until 5 January 2005 and so they had not been included in the branch books of account.

2. On 31 December 2004, the branch had transferred E15,000 of cash to the head office bank account, but this was not received in Mbabane until 2 January 2005.

Required:

- (a) Prepare in adjacent columns and using the vertical format (i) the head office, and (ii) the branch trading profit and loss for the year to 31 December 2004 (Note: a combined profit and loss account is not required).
- (b) Prepare in vertical format, Snel stores' balance sheet as at 31 December 2004 (Note: separate balance sheets for the head office and branch are not required).

Total (30 marks)

QUESTION 4

Masterfridge Limited filed for a voluntary liquidation in late January 2001 and it was on the newspapers that its failure was due to cash flow problems. At its year end in 30 June 2000 the auditors had issued a clean audit report and the company had used overdraft finance of E83 million. The overdraft finance already used was close to the overdraft limit of E90 million that was made available to the company by First National Bank. Using the financial ratios of the company on the table below, identify some of the possible causes that eventual led to its failure. (30 marks)

| Masterfridge Swaziland | Average | 2000 | 1999 | 1998 | 1997 | 1996 |
|-----------------------------------|----------------|-------------|-------------|-------------|-------------|-------------|
| Profitability ratios | | | | | | |
| Gross margin | 20% | 24% | 22% | 3% | 17% | 32% |
| Net profit margin | 4% | 7% | 6% | (12%) | 7% | 9% |
| Return on capital employed (Roce) | 9% | 22% | 20% | (36%) | 14% | 23% |
| Return on shareholders' funds | (4%) | 12% | 3% | (63%) | 14% | 14% |
| Efficiency ratios | | | | | | |
| Stock turnover period | 81 | 87 | 109 | 90 | 61 | 60 |
| Debtors collection period | 86 | 94 | 77 | 77 | 96 | 86 |
| Creditors payment period | 89 | 91 | 94 | 94 | 76 | 93 |
| Sales to capital employed | 3 | 3 | 3 | 3 | 2 | 3 |
| Liquidity ratios | | | | | | |
| Current ratio | 1.5 | 1.3 | 1.4 | 1.2 | 1.8 | 2.0 |
| Acid test ratio | 0.9 | 0.8 | 0.8 | 0.6 | 1.1 | 1.5 |
| Gearing and equity ratios | | | | | | |
| Total debt ratio | 56% | 64% | 64% | 69% | 45% | 36% |
| Total equity ratio | 44% | 36% | 36% | 31% | 55% | 64% |
| Interest cover ratio | (8.9) | 2.0 | 1.3 | (4.0) | (47.6) | 3.8 |
| Investment ratios | | | | | | |
| Earnings per share | 10.8 | 15.1 | 1.3 | (12.3) | 24.0 | 26.0 |
| P/E ratio | 0.18 | 0.03 | 0.71 | (0.29) | 0.33 | 0.12 |
| Edward Altman Z scores | 2.219 | 2.149 | 2.230 | 0.989 | 2.528 | 3.200 |

Additional information:

The share price of the company which might be useful in your analysis evolved as follows over the years:

| | Average | 2000 | 1999 | 1998 | 1997 | 1996 |
|-----------------|---------|------|------|------|------|------|
| Price per share | 3.3 | 0.52 | 0.89 | 3.6 | 8 | 3.25 |

Edward Altman (1968) in the USA model of corporate failure is stated as follows with respective interpretation:

$$Z \text{ score} = 1.2a + 1.4b + 3.3c + 0.6d + 1.0e$$

Where: a = (current assets - current liabilities) / total assets

b = total accumulated profits / total assets

c = Earnings before interest and taxes / total assets

d = Market value of equity and preference shares / total assets

e = Sales / Total assets

Companies with a Z score of less than 1.81 represent companies that are a prime candidate for bankruptcy, those between 1.81 and 2.99 are in a grey area (not clear whether represent companies that will fail or not) and those with a z score above 2.99 did not go bankrupt.

MASTERFRIDGE SWAZILAND LIMITED
INCOME STATEMENT FOR 30 JUNE

| | 2000 | 1999 | 1998 | 1997 | 1996 |
|--|----------|----------|----------|----------|----------|
| | E'000 | E'000 | E'000 | E'000 | E'000 |
| Revenue | 478,819 | 459,126 | 425,975 | 385,046 | 290,797 |
| Cost of sales | -365,914 | -360,244 | -411,597 | -318,308 | -197,792 |
| Gross profit | 112,905 | 98,882 | 14,378 | 66,738 | 93,005 |
| Profit before operating costs | 112,905 | 98,882 | 14,378 | 66,738 | 93,005 |
| Profit or loss on sale of subsidiaries | 3,282 | -738 | 0 | 0 | 0 |
| Net operating costs | -81,409 | -68,837 | -63,606 | -41,256 | -66,211 |
| | 34,778 | 29,307 | -49,228 | 25,482 | 26,794 |
| Share of results of associate | 84 | 0 | 0 | 0 | 0 |
| Profit before exceptional items, interest and taxation | 34,862 | 29,307 | -49,228 | 25,482 | 26,794 |
| Exceptional items | -2,726 | -2,659 | -5,170 | 0 | 0 |
| Profit before interest and taxation, but after exceptional items | 32,136 | 26,648 | -54,398 | 25,482 | 26,794 |
| Finance costs | -17,151 | -22,506 | -12,385 | 535 | -7,099 |
| Profit before taxation | 14,985 | 4,142 | -66,783 | 26,017 | 19,695 |
| Taxation | -970 | -739 | 1,613 | -3,880 | -3,656 |
| Profit after taxation | 14,015 | 3,403 | -65,170 | 22,137 | 16,039 |
| Outside shareholders' interest | 1,086 | -2,137 | 3,048 | -707 | -7 |
| Net profit attributable to ordinary shareholders | 15,101 | 1,266 | -62,122 | 21,430 | 16,032 |
| Proposed ordinary dividend | 0 | 0 | 0 | -7,927 | 0 |
| Transfer to non distributable reserves | 0 | 0 | 0 | 1,330 | -4 |
| Retained earnings for year | 15,101 | 1,266 | -62,122 | 14,833 | 16,028 |
| Retained earnings at start of year | -16,995 | -18,261 | 43,861 | 29,028 | 13,000 |
| Retained earnings at end of year | -1,894 | -16,995 | -18,261 | 43,861 | 29,028 |
| Earnings per ordinary share (cents) | 15.06 | 1.26 | -12.27 | 23.97 | 26.03 |

COURSE CODE: AC301-2 (M) 2005

BALANCE SHEET AS AT 30 JUNE

| | 2000 | 1999 | 1998 | 1997 | 1996 |
|--|----------------|----------------|----------------|----------------|----------------|
| | E'000 | E'000 | E'000 | E'000 | E'000 |
| Non current assets | | | | | |
| Property, plant and equipment | 94,293 | 85,658 | 94,987 | 70,045 | 30,210 |
| Goodwill | 7,892 | 8,811 | 0 | 30,700 | 26,467 |
| Research and development | 7,209 | 0 | 0 | 0 | 0 |
| Investments in associates | 85 | 0 | 0 | 0 | 0 |
| Fixed assets and intangibles assets | 109,479 | 94,469 | 94,987 | 100,745 | 56,677 |
| Current assets | | | | | |
| Inventories | 87,875 | 86,195 | 128,798 | 73,618 | 32,459 |
| Accounts receivable | 123,543 | 97,236 | 90,116 | 101,126 | 68,841 |
| Outside shareholders' interest | 5,254 | 796 | 2,110 | 0 | 0 |
| Cash on hand and at bank | 3,653 | 11,342 | 20,014 | 11,100 | 16,475 |
| | 220,325 | 195,569 | 241,038 | 185,844 | 117,775 |
| Current liabilities | | | | | |
| Accounts payable | 90,898 | 92,547 | 105,673 | 65,874 | 50,546 |
| Dividend proposed | 0 | 0 | 0 | 7,927 | 0 |
| Commissioner of taxes | 639 | 2,250 | 1,535 | 5,145 | 2,522 |
| Outside shareholders' interest | | | | 1,173 | 5,155 |
| Bank borrowings | 83,099 | 50,020 | 92,588 | 23,005 | 0 |
| | 174,636 | 144,817 | 199,796 | 103,124 | 58,223 |
| Working capital | 45,689 | 50,752 | 41,242 | 82,720 | 59,552 |
| | 155,168 | 145,221 | 136,229 | 183,465 | 116,229 |
| CAPITAL EMPLOYED | | | | | |
| Share capital and premium | 121,340 | 121,340 | 121,340 | 113,879 | 81,212 |
| Nondistributable reserves | 0 | 9 | 6 | 6 | 1,336 |
| Profit and loss account | -1,894 | -16,995 | -18,261 | 43,861 | 29,028 |
| Shareholders' funds | 119,446 | 104,354 | 103,085 | 157,746 | 111,576 |
| Long term liabilities | | | | | |
| Debentures | | | | 15,900 | |
| Long term liabilities | 35,722 | 40,680 | 33,050 | 7,435 | 3,406 |
| Deferred taxation | 0 | 187 | 94 | 2,384 | 1,247 |
| | 35,722 | 40,867 | 33,144 | 25,719 | 4,653 |
| | 155,168 | 145,221 | 136,229 | 183,465 | 116,229 |
| Total debt | 210,358 | 185,684 | 232,940 | 128,843 | 62,876 |
| Equity | 119,446 | 104,354 | 103,085 | 157,746 | 111,576 |
| Financing of assets | 329,804 | 290,038 | 336,025 | 286,589 | 174,452 |
| Total assets | 329,804 | 290,038 | 336,025 | 286,589 | 174,452 |
| Total debt ratio | 64% | 64% | 69% | 45% | 36% |
| Equity ratio | 36% | 36% | 31% | 55% | 64% |
| Total financing | 100% | 100% | 100% | 100% | 100% |
| | 2000 | 1999 | 1998 | 1997 | 1996 |
| Shares outstanding | 100,291,017 | 100,291,017 | 100,291,017 | 90,267,071 | 79772727 |
| Share price | 0.52 | 0.89 | 3.6 | 8 | 3.25 |
| Market value of company | 52,151,329 | 89,259,005 | 361,047,661 | 722,136,568 | 259,261,363 |