



CS FOUNDATION LEVEL

PILOT PAPER

PRINCIPLES OF ACCOUNTING AND TAXATION

December 2021.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings. Any assumptions made must be clearly and concisely stated.

RATES OF TAX (Including wife's employment, self-employment and professional income rates of tax).

Year of income 2020.

Assume that the following rates of tax applied throughout the year of income 2020:

| Monthly taxable pay (Sh.) | Annual taxable pay (Sh.) | Rate of tax % in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 24,000 | 1 - 288,000 | 10% |
| 24,001 - 40,667 | 288,001 - 488,000 | 15% |
| 40,668 - 57,334 | 488,001 - 688,000 | 20% |
| Excess over - 57,334 | Excess over - 688,000 | 25% |

Personal relief Sh.2,400 per month (Sh.28,800 per annum).

| Investment allowance: | Rate of investment allowance | Residual value (per year on reducing balance) | Prescribed benefit rates of motor vehicles provided by employer |
|---|----------------------------------|--|---|
| Capital expenditure incurred on: | | | (i) Saloons, Hatch Backs and Estates |
| | | | Monthly rates (Sh.) |
| | | | Annual rates (Sh.) |
| (a) Buildings: | | | Up to 1200 cc 3,600 43,200 |
| • Hotel building | 50% in the first year of use | 25% | 1201 - 1500 cc 4,200 50,400 |
| • Building used for manufacture | 50% in the first year of use | 25% | 1501 - 1750 cc 5,800 69,600 |
| • Hospital buildings | 50% in the first year of use | 25% | 1751 - 2000 cc 7,200 86,400 |
| • Petroleum or gas storage facilities | 50% in the first year of use | 25% | 2001 - 3000 cc 8,600 103,200 |
| • Educational/hostels building | 10% per year on reducing balance | | Over - 3000 cc 14,400 172,800 |
| • Commercial building | 10% per year on reducing balance | | |
| (b) Machinery: | | | (ii) Pick-ups, Panel Vans (unconverted) |
| • Machinery used for manufacture | 50% in the first year of use | 25% | Up to - 1750 cc 3,600 43,200 |
| • Hospital equipment | 50% in the first year of use | 25% | Over - 1750 cc 4,200 50,400 |
| • Ships or aircraft | 50% in the first year of use | 25% | |
| • Motor vehicles and heavy earth moving equipment | 25% per year on reducing balance | | |
| • Computer software, calculators, copiers and duplicating machines | 25% per year on reducing balance | | |
| • Furniture and fittings | 10% per year on reducing balance | | |
| • Telecommunication equipment | 10% per year on reducing balance | | |
| • Film equipment by a local producer | 25% per year on reducing balance | | |
| • Machinery used to undertake operations under prospecting rights and exploration under mining rights | 50% in the first year of use | 25% | |
| • Other machinery | 10% per year on reducing balance | | |
| (c) Purchase/acquisition of right to use fibre optic cable by telecommunication operation | 10% per year on reducing balance | | (iii) Land Rovers/Cruisers 7,200 86,400 |
| (d) Farm works | 50% in the first year of use | 25% | |

QUESTION ONE

- (a) The public Finance Management Act requires that, no later than 30 August in each year, the Cabinet Secretary shall issue to all National government entities a circular setting out guidelines on the budget process to be followed by them. With reference to the above provision, outline four contents of the circular. (4 marks)
- (b) Discuss four responsibilities of the National Treasury in the administration of the consolidated Fund. (8 marks)
- (c) Explain four fiscal responsibility principles enforced by the National Treasury in Managing National Government Public Finance. (8 marks)
- (Total: 20 marks)**

QUESTION TWO

Tom and Ken are partners sharing profits and losses in the ratio of 3:2 respectively. The partnership agreement provides for Ken to receive a salary of Ksh. 8 million per annum. Interest on capital allowed at the rate of 5% per annum.

Their statement of financial position as at 31 July 2020 was as follows:

| | Cost Sh. "000" | Depreciation Sh. "000" | Net book value Sh. "000" |
|--------------------------------|---------------------------|-----------------------------------|-------------------------------------|
| Non-current assets: | | | |
| Premises | 48,000 | 6,400 | 41,600 |
| Equipment | <u>16,000</u> | <u>9,600</u> | <u>6,400</u> |
| | <u>64,000</u> | <u>16,000</u> | 48,000 |
| Current assets: | | | |
| Inventory | | 11,200 | |
| Accounts receivable | | 4,400 | |
| Cash | | 800 | <u>16,400</u> |
| | | | <u>64,400</u> |
| Capital and liabilities | | | |
| Capital accounts: | | | |
| Tom | | 32,000 | |
| Ken | | 20,000 | 52,000 |
| Current accounts: | | | |
| Tom | | 6400 | |
| Ken | | (600) | 5,800 |
| Current liabilities | | | |
| Accounts payable | | | <u>6,600</u> |
| | | | <u>64,400</u> |

Additional Information;

- On 1 November 2020, Jude was admitted to the partnership. The terms of her admission were as follows:
Interest on capital was raised from 5% per annum to 6% per annum for all partners.
Jude introduced Sh. 24 million in cash as capital into the partnership.
Jude received a salary of Sh.12 million per annum. Ken's salary was raised to Sh.12 million per annum.
The profit-sharing ratio for Tom, Ken and Jude was adjusted to 4:2:1 respectively.
- The profit for the year ended 31 July 2021 was Sh.111,570,000
- As at 31 July 2021, the working capital of the partnership was as follows:

| | Sh. "000" |
|------------------------------|------------------|
| Inventory | 25,110 |
| Accounts receivable | 7,000 |
| Cash | 17,260 |
| Accounts payable and accrual | 6,960 |

- Partners drawings for the year ended 31 July 2021 were as follows:

| | Sh. "000" |
|------|------------------|
| Tom | 51,410 |
| Ken | 39,050 |
| Jude | 16,500 |

- The non-current assets are to be depreciated as follows:

| Asset | Rate per annum |
|-----------|----------------|
| Premises | 5% on cost |
| Equipment | 10% on cost |

Required:

- (a) Statement of profit or loss and appropriation account for the year ended 31 July 2021. (10 marks)
- (b) Partners current accounts. (4 marks)
- (c) Statement of financial position as at 31 July 2021. (6 marks)

(Total: 20 marks)**QUESTION THREE**

The following balances were extracted from the books of Hesabu Ltd. as at 31 December 2020:

| | Debit Sh. "000" | Credit Sh. "000" |
|--|----------------------------------|-----------------------------------|
| Trade receivables and trade payables | 4,500 | 3,960 |
| General reserves (1 January 2020) | | 3,800 |
| Gross profit for the period | | 13,610 |
| Inventories (31 December 2020) | 3,200 | |
| Ordinary share capital | | 7,000 |
| 10% preference capital | | 2,000 |
| Bad debts written off | 120 | |
| Salaries and wages | 2,940 | |
| Furniture and fittings (Cost Sh.7 million) | 5,600 | |
| Land at cost | 13,695 | |
| Revenue reserves (1 January 2020) | | 2,100 |
| Directors' fees | 900 | |
| Cash balance | 150 | |
| 12% Debentures | | 3,000 |
| Discounts Allowed and Discounts received | 170 | 85 |
| Allowance for doubtful debts | | 400 |
| Debenture interest paid | 300 | |
| Rental income | | 800 |
| Interim preference dividends paid | 180 | |
| Interim ordinary dividends paid | 130 | |
| Corporation tax paid | 410 | |
| Prepaid director fees | 150 | |
| Accrued rental income | 200 | |
| | <u>32,645</u> | <u>32,645</u> |

Additional Information

- Provisions as at 31 December 2020 are to be made as follows
 - Audit fees Sh.360,000
 - Outstanding debenture interest
- Included in the salaries and wages is Sh. 140,000 which relates to the month of January 2019.
- Allowances for doubtful debts are to be made at 10% of net trade receivables.
- Furniture and fittings are to be depreciated at 10% per annum on the net book values
- The directors have recommended that
 - Sh.700,000 be transferred to general reserves
 - Outstanding preference dividends and a 5 % ordinary dividend be paid for the whole year.

Required:

- (a) Income statement for the year ended 31 December 2020. (12 marks)
- (b) Statement of financial position as at 31 December 2020. (8 marks)

(Total: 20 marks)**QUESTION FOUR**

- (a) Explain the treatment of the following in taxation:
- Tax losses. (2 marks)
 - Capital losses. (2 marks)
- (b) Explain two distinguishing features between tax evasion and tax avoidance. (4 marks)

- (c) ABC Commenced a manufacturing operation on 1 May 2020 having incurred the following capital expenditure:

| | Sh. "000" |
|-------------------------------------|------------------|
| Factory buildings (Note 1) | 20,600 |
| Processing machinery | 4,800 |
| Factory parking bay | 1,640 |
| Sewerage system | 560,000 |
| Industrial effluent treatment plant | 2,400 |

Additional Information:

- | | Sh. "000" |
|--|------------------|
| 1. Factory building included the following: | |
| Cost of land | 4,400 |
| Godown | 800 |
| Showroom | 520 |
| Offices | 600 |
| Retail shop | 400 |
| 2. On 1 July 2020, the following capital expenditures were incurred: | |
| Photocopier | 60 |
| Computers | 150 |
| Motorbike | 96 |
| Saloon car | 3,400 |
| Fork lift | 720 |
| Furniture | 240 |
| Pick up | 920 |
| Scanners | 56 |
| Tractor | 1,700 |
| Carpets | 36 |
| 3. The company imported a weighting machine on 1 September 2020 at a cost of Sh.480,000 inclusive of duty of Sh.20,000. The duty was waived by the government. | |

Required:

Investment allowances due to the company for the year ended 31 December 2020.

(12 marks)

(Total: 20 marks)

QUESTION FIVE

- (a) Highlight two categories of goods liable under customs and excise duty Act. (2 marks)
- (b) Suggest four types of taxes used by a government in collecting tax revenue. (4 marks)
- (c) Explain two ways in which the Revenue Authority in your country might prevent loss of tax revenue from Imports (4 marks)
- (d) Discuss five challenges faced by a tax authority of a developing economy. (10 marks)

(Total: 20 marks)